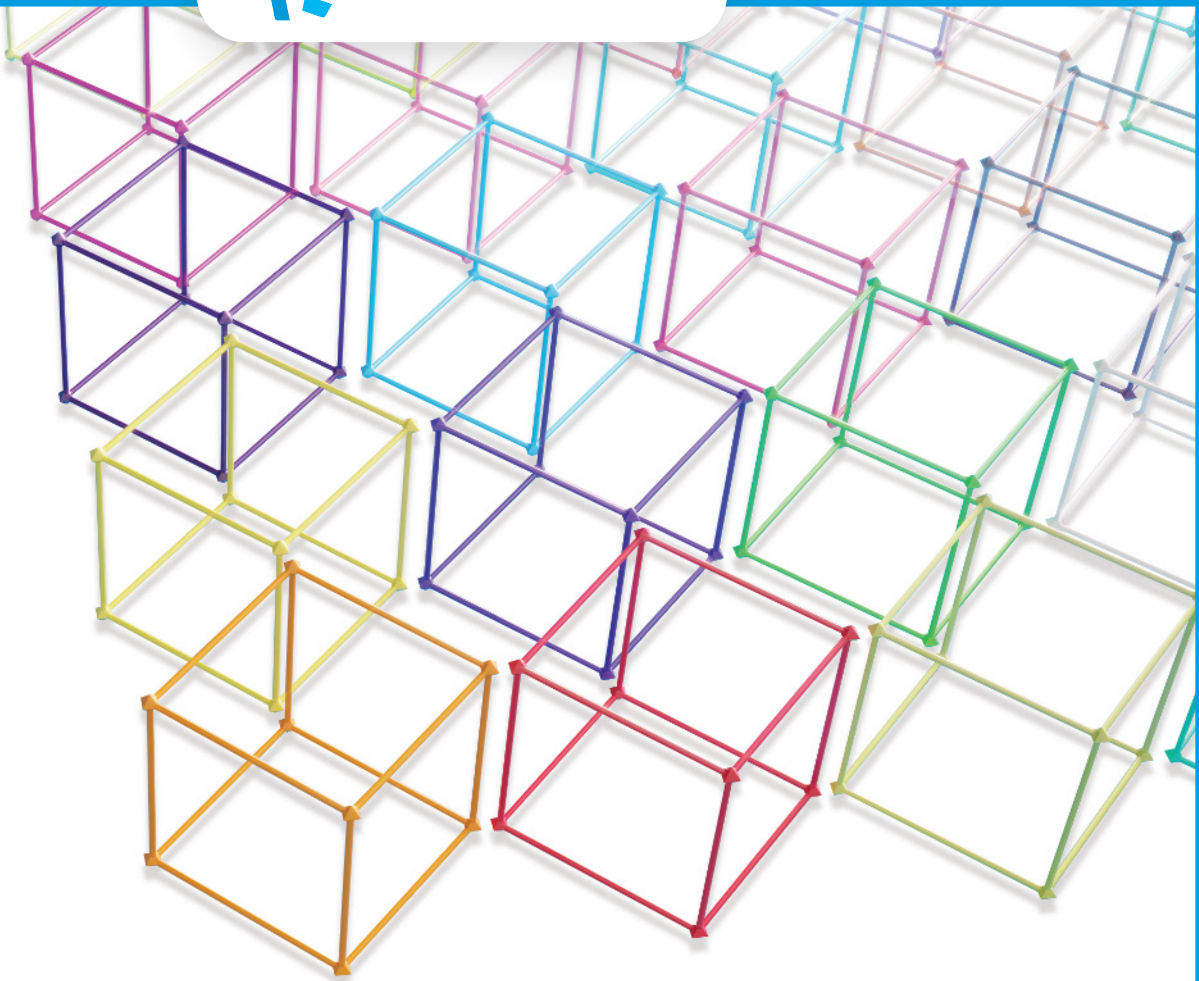
CENGAGE



Foundations of
BUSINESS

Pride • Hughes • Kapoor

7th Edition

Foundations of

BUSINESS

7th Edition

William M. Pride
Texas A&M University

Robert J. Hughes
Dallas College - Richland Campus

Jack R. Kapoor
College of DuPage

CENGAGE

Australia • Brazil • Canada • Mexico • Singapore • United Kingdom • United States

CENGAGE

***Foundations of Business*, 7e**
William M. Pride, Robert J. Hughes,
and Jack R. Kapoor

SVP, Higher Education Product Management: Erin Joyner

VP, Product Management, Learning Experiences: Thais Alencar

Product Director: Joe Sabatino

Product Manager: Heather Thompson

Product Assistant: Hannah May

Learning Designer: Megan Guiliani

Senior Content Manager: Allie Janneck

Digital Delivery Quality Partner: Amanda Ryan

Director, Product Marketing: Danae April

Portfolio Marketing Manager: Anthony Winslow

Product Development Researcher: Cara Suriyamongkol

IP Analyst: Diane Garrity

IP Project Manager: Nick Barrows

Production Service: MPS Limited

Designer: Sara Greenwood

Cover Image Source: Eoneren/iStock/Getty Images Plus/Getty Images

Interior image Source:

Technology and Innovation Box: 983457142 NicoElNino/iStock/Getty Images

Inside Business Box: 1136436788 ExperienceInteriors/E+/Getty Images

Ethics and Social Responsibility Box: 1163979032 sarayut Thaneerat/Moment/Getty Images

Sustaining the Planet Box: 1169552099 sarayut Thaneerat/Moment/Getty Images

Entrepreneurial Success Box: 1179537006 Chaiyawat Sripimonwan/EyeEm/Getty Images

Exploring Careers Box: 1223992751 Dilok Klaisataporn/iStock/Getty Images

Running a Business Case: 146070755 M. Unal Ozmen/Shutterstock.com

Last three editions, as applicable: © 2019, © 2017, © 2015

Copyright © 2023 Cengage Learning, Inc. ALL RIGHTS RESERVED.

No part of this work covered by the copyright herein may be reproduced or distributed in any form or by any means, except as permitted by U.S. copyright law, without the prior written permission of the copyright owner.

Unless otherwise noted, all content is Copyright © Cengage Learning, Inc.

Microsoft is a registered trademark of Microsoft Corporation in the U.S. and/or other countries.

The names of all products mentioned herein are used for identification purposes only and may be trademarks or registered trademarks of their respective owners. Cengage Learning disclaims any affiliation, association, connection with, sponsorship, or endorsement by such owners.

For product information and technology assistance, contact us at **Cengage Customer & Sales Support, 1-800-354-9706** or **support.cengage.com**.

For permission to use material from this text or product, submit all requests online at **www.copyright.com**.

Library of Congress Control Number: 2021914585

Soft-Cover Edition:
ISBN: 978-0-357-71794-3

Loose-Leaf Edition:
ISBN: 978-0-357-71795-0

Cengage
200 Pier 4 Boulevard
Boston, MA 02210
USA

Cengage is a leading provider of customized learning solutions with employees residing in nearly 40 different countries and sales in more than 125 countries around the world. Find your local representative at **www.cengage.com.**

To learn more about Cengage platforms and services, register or access your online learning solution, or purchase materials for your course, visit **www.cengage.com.**

Printed in the United States of America
Print Number: 01 Print Year: 2022

LETTER FROM THE AUTHORS

Dear Business Students,

Take a moment and imagine what your life will be like in 5, 10, or 20 years from now. For some, life becomes a joyous experience that brings the rewards of a life well lived. For others, life doesn't turn out quite the way you imagined. Often, the difference is the decisions you make as you go through life. Those decisions can make the difference—a real difference—in the type of life you experience. Regardless of your personal goals, we have written this text with one purpose: to provide the information you need to make decisions that will help you succeed in today's business world and in your personal life.

This new edition of *Foundations of Business* is packed with information that can help you reach your personal goals and launch a successful career. We worked hard to make sure there's something in every chapter to help you understand the world of business and become a better employee, a more informed consumer, and, if it's your dream, a successful business owner. Each chapter contains an opening case and an end-of-chapter case that showcase how companies like Walmart, Google, Whole Foods, S.C. Johnson, Southwest Airlines, and Taco Bell tackle real-world problems. In addition, each chapter includes special box features that provide information about careers, social responsibility, technology, environmental issues, and entrepreneurship.

We also realize that students learn in different ways. Information and feedback from students helped guide the development of different activities that can help you learn the important concepts needed for a successful career. We're especially proud of the following learning activities in the text and its website:

- Concept Checks at the end of major sections in every chapter
- Chapter Summaries and Discussion Questions
- Social Media Exercises
- Building Team Exercises
- Career Research Activities
- Student PowerPoints®
- Learning activities and assessment material in the MindTap learning system that accompanies the text

As authors, we believe that success is measured not only by the grade you receive in this course, but also by how you use the information in this text to build a foundation for a better life. It's time! Take the next step and read Chapter 1 to see how the new edition of *Foundations of Business* can help you learn about business and enjoy success in not only your career, but also your life.

Sincerely,

Bill Pride
w-pride@tamu.edu

Bob Hughes
Hughespublishing@outlook.com

Jack Kapoor
kapoorj@att.net

To Nancy, Allen, Carmen, Gracie, Marie, Mike, Ashley, Charlie, J.R., Anderson, and Maggie Pride

To my wife Robin and the memory of my mother Barbara Hughes

To my wife Theresa; my children Karen, Kathryn, and Dave; and in memory of my parents Ram and Sheela Kapoor

Brief Contents

PART 1 The Environment of Business 1
Chapter 1 Exploring the World of Business and Economics 2
Chapter 2 Ethics and Social Responsibility in Business 36
Chapter 3 Global Business 67

PART 2 Business Ownership and Entrepreneurship 100
Chapter 4 Choosing a Form of Business Ownership 101
Chapter 5 Small Business, Entrepreneurship, and Franchises 130

PART 3 Management and Organization 162
Chapter 6 Understanding the Management Process 163
Chapter 7 Creating a Flexible Organization 185
Chapter 8 Producing Quality Goods and Services 210

PART 4 Human Resources 244
Chapter 9 Attracting and Retaining the Best Employees 245
Chapter 10 Motivating and Satisfying Employees 274

PART 5 Marketing 302
Chapter 11 Building Customer Relationships Through Effective Marketing 303
Chapter 12 Creating and Pricing Products That Satisfy Customers 329
Chapter 13 Distributing and Promoting Products 363

PART 6 Information, Accounting, and Finance 400
Chapter 14 Exploring Social Media and e-Business 401
Chapter 15 Using Management and Accounting Information 433
Chapter 16 Mastering Financial Management 465

Endnotes E-1
Glossary G-1
Name Index NI-1
Subject Index SI-1

The following Online-Only Chapters and Appendices appear on the companion site and within the MindTap Reader:

Online-Only Chapter 17: Understanding Personal Finances and Investments 17-1
Online-Only Chapter 18: Enhancing Union-Management Relations 18-1

Appendix A: Careers in Business A-1
Appendix B: Risk Management and Insurance B-1
Appendix C: Business Law, Regulation, and Taxation C-1

Contents

Acknowledgments xiv

About the Authors xv

PART 1 The Environment of Business 1

Chapter 1: Exploring the World of Business and Economics 2

→ ***Inside Business:*** Tesla Races Ahead of the Competition 3

1-1 Your Future in the Changing World of Business 4
  - *1-1a Why Study Business? 5*

Exploring Careers: Gen Z Seeks Workplace Diversity 6
  - *1-1b Special Note to Business Students 8*

1-2 Business: A Definition 9
  - *1-2a The Organized Effort of Individuals 9*
  - *1-2b Satisfying Needs 10*
  - *1-2c Business Profit 11*

1-3 Types of Economic Systems 12

Entrepreneurial Success: The Next Wave of Entrepreneurs Is Here 14
  - *1-3a Capitalism 14*
  - *1-3b Capitalism in the United States 15*
  - *1-3c Command Economies 17*

1-4 Measuring Economic Performance 18
  - *1-4a The Importance of Productivity in the Global Marketplace 18*
  - *1-4b The Nation's Gross Domestic Product 19*
  - *1-4c Other Important Economic Indicators That Measure a Nation's Economy 20*

1-5 The Business Cycle 20

Sustaining the Planet: The North Face Believes Sustainability and Social Responsibility Sell 21

1-6 Types of Competition 22
  - *1-6a Perfect Competition 23*
  - *1-6b Monopolistic Competition 24*
  - *1-6c Oligopoly 25*
  - *1-6d Monopoly 25*

1-7 American Business Today 26
  - *1-7a Early Business Development 26*
  - *1-7b Business Development in the 1900s 27*
  - *1-7c A New Century: 2000 and Beyond 28*
  - *1-7d The Current Business Environment 28*

Technology and Innovation: Today's Biggest Tech Trends 30
  - *1-7e The Challenges Ahead 31*

Summary 32

Key Terms 33

Discussion Questions 33

Case 1: The Keys to Zoom's Success 34

Building Skills for Career Success 35

Chapter 2: Ethics and Social Responsibility in Business 36

→ ***Inside Business:*** Marketing Tactics at Purdue Fueled the Opioid Crisis 37

2-1 Business Ethics Defined 38

2-2 Ethical Issues In Business 38
  - *2-2a Fairness and Honesty 38*
  - *2-2b Organizational Relationships 39*
  - *2-2c Conflicts of Interest 40*
  - *2-2d Communications 41*

Entrepreneurial Success: Building a Healthy Relationship with Social Media 41

2-3 Factors Affecting Ethical Behavior 42
  - *2-3a Individual Factors Affecting Ethics 42*
  - *2-3b Social Factors Affecting Ethics 42*
  - *2-3c Opportunity as a Factor Affecting Ethics 43*

2-4 Encouraging Ethical Behavior 43
  - *2-4a Government's Role in Encouraging Ethics 43*
  - *2-4b Trade Associations' Role in Encouraging Ethics 44*
  - *2-4c Individual Companies' Role in Encouraging Ethics 44*

Exploring Careers: The Rise of the Chief Ethics Officer 46

2-5 Social Responsibility 47
  - *2-5a The Evolution of Social Responsibility in Business 48*
  - *2-5b Two Views of Social Responsibility 49*
  - *2-5c The Pros and Cons of Social Responsibility 50*

2-6 Public Responsibilities of Business 51
  - *2-6a Consumerism 51*

Ethics and Social Responsibility: Google Sued for Antitrust Violations 52
  2-6b Public Health 53
2-7 Responsibilities to Employees 55
  2-7a Affirmative Action Programs 55
  2-7b Training Programs for the Hard-Core Unemployed 56
  2-7c Programs to Reduce Sexual Harassment and Abusive Behavior 57
2-8 Responsibilities to the Environment 58
  2-8a Environmental Issues 58
  2-8b Effects of Environmental Legislation 59
  2-8c Business Response to Environmental Concerns 60
Sustaining the Planet: Is Sustainability Profitable? 61
2-9 Implementing a Program of Social Responsibility 62
  2-9a Commitment of Top Executives 62
  2-9b Planning 62
  2-9c Appointment of a Director 62
  2-9d The Social Audit 63
Summary 63
Key Terms 64
Discussion Questions 64
Case 2: Inside Whole Trade at Whole Foods 65
Building Skills for Career Success 65

Chapter 3: Global Business 67

→ **Inside Business:** Starbucks Goes Global for Growth 68
Entrepreneurial Success: Alibaba Transforms China by Investing in Entrepreneurs 69
3-1 The Basis for International Business 69
  3-1a Absolute and Comparative Advantage 69
  3-1b Exporting and Importing 70
  3-1c Balance of Trade 70
  3-1d The Economic Outlook for Trade 73
Technology and Innovation: Spotify Makes a Play for Global Dominance 75
3-2 Methods of Entering International Business 76
  3-2a Exporting 76
  3-2b Licensing and Franchising 78
  3-2c Contract Manufacturing 79
  3-2d Joint Ventures and Alliances 79
  3-2e Direct Investment 80
  3-2f Multinational Firms 80
Sustaining the Planet: IKEA Opens Its First Second-Hand Store 81
3-3 International Business Challenges 81
  3-3a Trade Restrictions 81
  3-3b Economic Challenges 84
Ethics and Social Responsibility: Opening the Gates to Digital Payments 85
  3-3c Legal and Political Climate 85
  3-3d Social and Cultural Barriers 85
3-4 Facilitators of International Trade 86
  3-4a The General Agreement on Tariffs and Trade and the World Trade Organization 86
  3-4b International Trade Agreements and Alliances 86
3-5 Sources of Export Assistance 89
3-6 Financing International Business 90
  3-6a The Export-Import Bank of the United States 90
  3-6b The World Bank 91
  3-6c The International Monetary Fund 91
Summary 92
Key Terms 93
Discussion Questions 93
Case 3: Honda's Strategy Is Electrifying 93
Building Skills for Career Success 94
Running a Business: Part 1: Let's Go Get a Graeter's! 96
Building a Business Plan: Part 1 97

PART 2 Business Ownership and Entrepreneurship 100

Chapter 4: Choosing a Form of Business Ownership 101

→ **Inside Business:** Amazon Accelerates with Autonomous Vehicle Acquisition 102
4-1 Sole Proprietorships 103
  4-1a Advantages of Sole Proprietorships 104
  4-1b Disadvantages of Sole Proprietorships 105
  4-1c Beyond the Sole Proprietorship 106
Ethics and Social Responsibility: How American Express Helps Small Businesses 106
4-2 Partnerships 107
  4-2a Types of Partners 107
  4-2b The Partnership Agreement 108
4-3 Advantages and Disadvantages of Partnerships 109
  4-3a Advantages of Partnerships 109
  4-3b Disadvantages of Partnerships 110
  4-3c Beyond the Partnership 111
4-4 Corporations 111
  4-4a Corporate Ownership 112
  4-4b Forming a Corporation 112
  4-4c Corporate Structure 114
4-5 Advantages and Disadvantages of Corporations 115
  4-5a Advantages of Corporations 115
Sustaining the Planet: Sustainable-Minded Businesses Eye B Corp Certification 117
  4-5b Disadvantages of Corporations 117
4-6 Special Types of Business Ownership 118
  4-6a S Corporations 119
  4-6b Limited Liability Companies 119
  4-6c Not-for-Profit Corporations 120
Entrepreneurial Success: How to Form an LLC for Your Small Business 121
4-7 Joint Ventures and Syndicates 121
  4-7a Joint Ventures 121
  4-7b Syndicates 122

4-8 Corporate Growth 122
    4-8a Growth from Within 122
Technology and Innovation: Intel Gets a Move On with Mobileye and Moovit 123
    4-8b Growth Through Mergers and Acquisitions 124
    4-8c Merger and Acquisition Trends for the Future 125
Summary 125
Key Terms 126
Discussion Questions 127
Case 4: It's a Family Affair at SC Johnson 127
Building Skills for Career Success 128

Chapter 5: Small Business, Entrepreneurship, and Franchises 130

→ **Inside Business:** Taco Bell Becomes One of the Fastest Growing Franchises 131
5-1 Small Business: a Profile 132
    5-1a The Small-Business Sector 133
    5-1b The Importance of Small Business in Our Economy 133
    5-1c Industries That Attract Small Businesses 135
Exploring Careers: Tips for Aspiring Entrepreneurs 136
5-2 The People in Small Businesses: The Entrepreneurs 136
    5-2a Characteristics of Entrepreneurs 136
    5-2b Women as Small-Business Owners 138
Entrepreneurial Success: A Perfect Fit: How a Teen Landed a Deal with the Founder of TOMS 139
    5-2c Teenagers as Small-Business Owners 139
    5-2d Immigrants as Entrepreneurs 139
5-3 The Pros and Cons of Smallness 140
    5-3a Advantages of Small Businesses 140
    5-3b Disadvantages of Small Businesses 142
Technology and Innovation: COVID-19 Challenges American Innovation 142
5-4 Why Some Entrepreneurs and Small Businesses Fail 143
5-5 The Importance of a Business Plan 144
5-6 Franchising 145
    5-6a What Is Franchising? 145
    5-6b The Growth of Franchising 146
    5-6c Types of Franchising 147
Sustaining the Planet: Inside Oxi Fresh's Franchise Growth 148
    5-6d Advantages of Franchising 148
    5-6e Disadvantages of Franchising 149
5-7 Financing the Small Business 150
    5-7a Equity Financing 151
    5-7b Debt Financing 152
    5-7c Crowdfunding 152
5-8 The Small Business Administration: Resources for Entrepreneurs 152
    5-8a SBA Management Assistance 152
    5-8b SBA Financial Assistance 154
    5-8c Help for Small Businesses Owned by Underrepresented Groups 155
5-9 Global Perspectives in Small Business 156
Summary 156
Key Terms 157
Discussion Questions 158
Case 5: Traits of the Most Successful Entrepreneurs 158
Building Skills for Career Success 159
    Running a Business: Part 2: Graeter's: A Fourth-Generation Family Business 160
    Building a Business Plan: Part 2 161

PART 3 Management and Organization 162

Chapter 6: Understanding the Management Process 163

→ **Inside Business:** Hands-On Investors Question Twitter's Hands-Off Management 164
6-1 What Is Management? 164
6-2 Basic Management Functions 165
    6-2a Planning 165
    6-2b Organizing the Enterprise 169
    6-2c Leading and Motivating 170
    6-2d Controlling Ongoing Activities 170
6-3 Kinds of Managers 171
    6-3a Levels of Management 171
    6-3b Areas of Management Specialization 172
Ethics and Social Responsibility: Radical Transparency at Everlane Goes Bust 174
6-4 Key Skills of Successful Managers 174
    6-4a Conceptual Skills 174
    6-4b Analytic Skills 174
    6-4c Interpersonal Skills 175
    6-4d Technical Skills 175
Technology and Innovation: Will AI Replace Managers? 176
    6-4e Communication Skills 176
6-5 Leadership 176
    6-5a Formal and Informal Leadership 176
    6-5b Styles of Leadership 177
Exploring Careers: Top Traits of Good Managers, According to Google 178
    6-5c Which Leadership Style Is the Best? 178
6-6 Managerial Decision Making 179
    6-6a Identifying the Problem or Opportunity 179
Entrepreneurial Success: Jeff Bezos Reveals His Secret to Making High-Stakes Decisions 180
    6-6b Generating Alternatives 180
    6-6c Selecting an Alternative 180
    6-6d Implementing and Evaluating the Solution 180
Summary 181
Key Terms 182
Discussion Questions 182
Case 6: Tesla: From Start-Up to Wall Street Darling 182
Building Skills for Career Success 183

Chapter 7: Creating a Flexible Organization 185

→ *Inside Business:* Coca-Cola Shakes It Up with a Reorganization Plan 186

7-1 What Is an Organization? 186

Entrepreneurial Success: Mikaila Ulmer Builds a Business to Save the Bees 187

7-2 Job Design 188
    7-2a Job Specialization 189
    7-2b Alternatives to Job Specialization 190

7-3 Departmentalization 190
    7-3a By Function 190
    7-3b By Product 191
    7-3c By Location 191
    7-3d By Customer 191
    7-3e Combinations of Bases 191

Technology and Innovation: How Apple's Organizational Structure Supports Innovation 192

7-4 Delegation, Decentralization, and Centralization 193
    7-4a Delegation of Authority 193

Ethics and Social Responsibility: Top Managers Feel Pressure to Bend the Rules 194
    7-4b Decentralization of Authority 194

7-5 The Span of Management 195
    7-5a Wide and Narrow Spans of Management 195
    7-5b Organizational Height 196

7-6 Forms of Organizational Structure 196
    7-6a The Line Structure 196
    7-6b The Line-and-Staff Structure 197
    7-6c The Matrix Structure 198
    7-6d The Virtual Structure 199

7-7 Teams and Teamwork 200
    7-7a What Is a Team? 200
    7-7b Types of Teams 200
    7-7c Developing and Using Effective Teams 201

Exploring Careers: Preparing for a Virtual Career 202
    7-7d Roles within a Team 203
    7-7e Team Cohesiveness 203
    7-7f Team Conflict and How to Resolve It 203
    7-7g Benefits and Limitations of Teams 204

7-8 Committees and Task Forces 204

7-9 The Informal Organization and the Grapevine 205

Summary 206
Key Terms 207
Discussion Questions 207
Case 7: Sweetgreen Stays True to Its Roots 207
Building Skills for Career Success 208

Chapter 8: Producing Quality Goods and Services 210

→ *Inside Business:* Tech Giants Double Down on R&D 211

8-1 What Is Production? 212
    8-1a How American Manufacturers Compete in the Global Marketplace 212
    8-1b Careers in Operations Management 214

Entrepreneurial Success: Entrepreneurs and Digital Manufacturing 215

8-2 The Conversion Process 216
    8-2a Production Using a Conversion Process 216

8-3 The Increasing Importance of Services 217
    8-3a Planning Quality Services 217
    8-3b Evaluating the Quality of a Firm's Services 218

8-4 Where Do New Products and Services Come From? 218
    8-4a Research and Development 219
    8-4b Product Extension and Refinement 219

Sustaining the Planet: How to Build Sustainable and Resilient Manufacturing 220

8-5 How Do Managers Plan Production? 221
    8-5a Design Planning 221
    8-5b Site Selection and Facilities Planning 223
    8-5c Operational Planning 225

8-6 Operations Control 226
    8-6a Purchasing 226
    8-6b Inventory Control 227
    8-6c Scheduling 228

Technology and Innovation: Walmart Puts Inventory-Tracking Robots on the Curb 228
    8-6d Quality Control 229
    8-6e Production Planning: A Summary 231

8-7 Improving Productivity with Technology 232
    8-7a Productivity Trends 232

Ethics and Social Responsibility: What It Takes to Be an Ethical Manufacturer 233
    8-7b Improving Productivity Growth 234
    8-7c The Impact of Automation, Robotics, and Computers on Productivity 234
    8-7d Sustainability and Technological Displacement 236

Summary 236
Key Terms 238
Discussion Questions 238
Case 8: Toyota Drives Change in Manufacturing 238
Building Skills for Career Success 239

Running a Business: Part 3: Graeter's Grows Through Good Management, Organization, and Quality 241

Building a Business Plan: Part 3 242

PART 4 Human Resources 244

Chapter 9: Attracting and Retaining the Best Employees 245

→ *Inside Business:* Chipotle Freshens Up Its Parental Benefits 246

9-1 Human Resources Management: An Overview 246
    9-1a HRM Activities 247
    9-1b Responsibility for HRM 248

9-2 Human Resources Planning 248
    9-2a Forecasting Human Resources Demand 248
    9-2b Forecasting Human Resources Supply 249
    9-2c Matching Supply with Demand 249

9-3 Workplace Diversity 250
Ethics and Social Responsibility: Apple Doubles Down on Racial Equity 251
9-4 Job Analysis 252
Exploring Careers: Sharpen These In-Demand Skills 253
9-5 Recruiting, Selection, and Onboarding 253
- *9-5a Recruiting 253*

Technology and Innovation: Career Fairs Go Online 254
- *9-5b Selection 255*
- *9-5c Onboarding 257*

9-6 Compensation and Benefits 258
- *9-6a Compensation Decisions 258*
- *9-6b Types of Compensation 259*
- *9-6c Closing the Gender Gap 260*
- *9-6d Employee Benefits 260*

Entrepreneurial Success: Small Businesses Focus on Better Benefits 262
9-7 Training and Development 262
- *9-7a Analysis of Training Needs 263*
- *9-7b Training and Development Methods 263*
- *9-7c Evaluation of Training and Development 263*

9-8 Performance Appraisal 264
- *9-8a Common Evaluation Techniques 264*
- *9-8b Performance Feedback 266*

9-9 Employee Turnover 267
9-10 The Legal Environment of HRM 267
- *9-10a Civil Rights Acts 268*
- *9-10b Affirmative Action 269*
- *9-10c Employee Safety 269*
- *9-10d Employees with Disabilities 270*

Summary 270
Key Terms 271
Discussion Questions 272
Case 9: Taco Bell Tackles Large-Scale Recruitment 272
Building Skills for Career Success 273

Chapter 10: Motivating and Satisfying Employees 274

→ **Inside Business:** Whole Foods Gives the Whole Picture with Wage Transparency 275
10-1 What Is Motivation? 275
10-2 Historical Perspectives on Motivation 276
- *10-2a Scientific Management 276*
- *10-2b The Hawthorne Studies 277*
- *10-2c Maslow's Hierarchy of Needs 278*
- *10-2d Herzberg's Motivation-Hygiene Theory 279*
- *10-2e Theory X and Theory Y 281*
- *10-2f Theory Z 282*
- *10-2g Reinforcement Theory 282*

10-3 Contemporary Views of Motivation 283
- *10-3a Equity Theory 283*
- *10-3b Expectancy Theory 284*
- *10-3c Goal-Setting Theory 285*

10-4 Organizational Culture 285
Exploring Careers: Vet Employer Values to Avoid an Early Exit 286
10-5 Key Motivation Techniques 288
- *10-5a Management by Objectives 288*
- *10-5b Job Enrichment 289*
- *10-5c Behavior Modification 290*
- *10-5d Flexible Scheduling Options 290*

Entrepreneurial Success: How to Recognize Employees for a Job Well Done 291
- *10-5e Part-Time Work and Job Sharing 292*
- *10-5f Telecommuting 293*

Technology and Innovation: The Work-From-Home Revolution Goes High-Tech 293
- *10-5g Employee Empowerment 294*

Ethics and Social Responsibility: HP Empowers Employees for Good 295
- *10-5h Employee Ownership 295*

Summary 296
Key Terms 297
Discussion Questions 297
Case 10: Google's Employee Perks Satisfy 297
Building Skills for Career Success 298
Running a Business: Part 4: At Graeter's, Tenure Is "a Proud Number" 300
Building a Business Plan: Part 4 301

PART 5 Marketing 302

Chapter 11: Building Customer Relationships Through Effective Marketing 303

→ **Inside Business:** Netflix Tops the Competition in Customer Retention 304
11-1 Managing Customer Relationships 305
Sustaining the Planet: Customer Feedback Pushes Native to Go Plastic-Free 306
11-2 Utility: The Value Added by Marketing 307
11-3 The Marketing Concept 308
- *11-3a Evolution of the Marketing Concept 308*
- *11-3b Implementing the Marketing Concept 309*

11-4 Markets and Their Classification 310
11-5 Developing Marketing Strategies 310
- *11-5a Target Market Selection and Evaluation 310*
- *11-5b Creating a Marketing Mix 313*

11-6 Marketing Strategy and the Marketing Environment 315
11-7 Developing a Marketing Plan 316
11-8 Market Measurement and Sales Forecasting 317
11-9 Marketing Information 317
- *11-9a Collecting and Analyzing Marketing Information 317*

Exploring Careers: Trend Alert: Market Research Analysts Are in High Demand 318

- ***Technology and Innovation:*** TikTok Uses AI and Big Data to Keep Users Coming Back for More 319
    - *11-9b Marketing Research 320*
- ***Ethics and Social Responsibility:*** Marketers Must Embrace Data Ethics 322
- 11-10 Types of Buying Behavior 322
    - *11-10a Consumer Buying Behavior 322*
    - *11-10b Business Buying Behavior 324*
- Summary 324
- Key Terms 326
- Discussion Questions 326
- ***Case 11:*** Starbucks Brews Customer Satisfaction 326
- Building Skills for Career Success 327

Chapter 12: Creating and Pricing Products That Satisfy Customers 329

- → ***Inside Business:*** Petco Rebrand Focuses on Pet Health and Wellness 330
- 12-1 Classification of Products 331
    - *12-1a Consumer Product Classifications 331*
    - *12-1b Business Product Classifications 332*
- 12-2 The Product Life Cycle 333
    - *12-2a Stages of the Product Life Cycle 333*
- ***Sustaining the Planet:*** Consumers Go Flexitarian with Fake Meat 334
    - *12-2b Using the Product Life Cycle 336*
- 12-3 Product Line and Product Mix 336
- 12-4 Managing the Product Mix 336
    - *12-4a Managing Existing Products 337*
- ***Exploring Careers:*** Are You Ready for a Career in Product Management? 338
    - *12-4b Deleting Products 338*
    - *12-4c Developing New Products 339*
- ***Technology and Innovation:*** High-Tech Is High Fashion 341
    - *12-4d Why Do Products Fail? 341*
- 12-5 Branding, Packaging, and Labeling 342
    - *12-5a What Is a Brand? 342*
    - *12-5b Types of Brands 342*
    - *12-5c Benefits of Branding 343*
    - *12-5d Choosing and Protecting a Brand 344*
    - *12-5e Branding Strategies 345*
    - *12-5f Brand Extensions 345*
    - *12-5g Packaging 345*
    - *12-5h Labeling 347*
- 12-6 Pricing Products 347
    - *12-6a The Meaning and Use of Price 347*
    - *12-6b Price and Non-Price Competition 348*
- ***Ethics and Social Responsibility:*** Companies Rebrand to Be More Sensitive 349
    - *12-6c Buyers' Perceptions of Price 349*
- 12-7 Pricing Objectives 349
    - *12-7a Survival 350*
    - *12-7b Profit Maximization 350*
    - *12-7c Target Return on Investment 350*
    - *12-7d Market-Share Goals 350*
    - *12-7e Status-Quo Pricing 350*
- 12-8 Pricing Methods 351
    - *12-8a Cost-Based Pricing 351*
    - *12-8b Demand-Based Pricing 352*
    - *12-8c Competition-Based Pricing 353*
- 12-9 Pricing Strategies 353
    - *12-9a New-Product Pricing 353*
    - *12-9b Differential Pricing 354*
    - *12-9c Psychological Pricing 355*
    - *12-9d Product-Line Pricing 356*
    - *12-9e Promotional Pricing 356*
- 12-10 Pricing Business Products 357
    - *12-10a Geographic Pricing 357*
    - *12-10b Transfer Pricing 357*
    - *12-10c Discounting 357*
- Summary 358
- Key Terms 360
- Discussion Questions 360
- ***Case 12:*** Shinola Is One to Watch 361
- Building Skills for Career Success 361

Chapter 13: Distributing and Promoting Products 363

- → ***Inside Business:*** Walmart Brings Its Buying Teams Together 364
- 13-1 Distribution Channels and Market Coverage 365
    - *13-1a Commonly Used Distribution Channels 365*
    - *13-1b Level of Market Coverage 367*
- 13-2 Partnering Through Supply-Chain Management 367
- ***Sustaining the Planet:*** Millennials Take a Shining to Ethically Sourced Diamonds 368
- 13-3 Marketing Intermediaries: Wholesalers 368
    - *13-3a Wholesalers Provide Services to Retailers and Manufacturers 369*
    - *13-3b Types of Wholesalers 369*
- 13-4 Marketing Intermediaries: Retailers 370
    - *13-4a Online and Multichannel Retailing 370*
    - *13-4b Types of Retail Stores 371*
    - *13-4c Types of Shopping Centers 373*
    - *13-4d Nonstore Retailing 374*
- 13-5 Logistics 376
- ***Technology and Innovation:*** Drone Delivery Takes Off 376
    - *13-5a Inventory Management 377*
    - *13-5b Order Processing 377*
    - *13-5c Warehousing 377*
    - *13-5d Materials Handling 378*
    - *13-5e Transportation 378*
- 13-6 What Is Integrated Marketing Communications? 379
- 13-7 The Promotion Mix: An Overview 380
- 13-8 Advertising 381
    - *13-8a Types of Advertising by Purpose 381*
    - *13-8b Major Steps in Developing an Advertising Campaign 382*
    - *13-8c Advertising Agencies 384*
- ***Exploring Careers:*** How to Land a Job in an Advertising Agency 385
    - *13-8d Social and Legal Considerations in Advertising 385*
- 13-9 Personal Selling 386
    - *13-9a Kinds of Salespersons 386*
    - *13-9b The Personal-Selling Process 387*
    - *13-9c Major Sales Management Tasks 388*
- 13-10 Sales Promotion 388
    - *13-10a Sales Promotion Objectives 388*
    - *13-10b Sales Promotion Methods 389*
    - *13-10c Selection of Sales Promotion Methods 390*

13-11 Public Relations 390
  13-11a Types of Public-Relations Tools 390
Entrepreneurial Success: Inside BODEN, an Award-Winning, Latina-Owned PR Company 391
  13-11b Uses of Public Relations 392
Summary 392
Key Terms 394
Discussion Questions 394
Case 13: Casper Thinks Inside the Box 394
Building Skills for Career Success 395
  Running a Business: Part 5: Graeter's Is "Synonymous with Ice Cream" 397
  Building a Business Plan: Part 5 398

PART 6 Information, Accounting, and Finance 400

Chapter 14: Exploring Social Media and e-Business 401

→ **Inside Business:** Netflix Tops the Competition in Customer Retention 402
14-1 Why Is Social Media Important? 403
  14-1a What Is Social Media and How Popular Is It? 403
  14-1b Why Businesses Use Social Media 403
14-2 Social Media Tools for Business Use 405
  14-2a Business Use of Blogs 405
Exploring Careers: HBO Max Interns Rock TikTok 406
  14-2b Photos, Videos, and Podcasts 406
  14-2c Social Media Ratings 407
14-3 Achieving Business Objectives Through Social Media 408
  14-3a Social Media Communities 408
  14-3b Crisis and Reputation Management 409
  14-3c Listening to Stakeholders 410
Technology and Innovation: VW's April Fools' Day Prank Backfires 410
  14-3d Targeting Customers 411
  14-3e Social Media Marketing for Consumers 411
  14-3f Social Media Marketing for Other Businesses 412
  14-3g Generating New Product Ideas 413
  14-3h Recruiting Employees 414
14-4 Developing a Social Media Plan 414
  14-4a Steps to Build a Social Media Plan 414
  14-4b Measuring and Adapting a Social Media Plan 416
  14-4c The Cost of Maintaining a Social Media Plan 418
14-5 Defining e-Business 418
  14-5a Organizing e-Business Resources 419
  14-5b Satisfying Needs Online 419
Entrepreneurial Success: Why Small Businesses Like Shopify 420
  14-5c Creating e-Business Profit 421
14-6 Fundamental Models of e-Business 422
  14-6a Business-to-Business (B2B) Model 422
  14-6b Business-to-Consumer (B2C) Model 423
14-7 The Future of the Internet, Social Media, and e-Business 424
  14-7a Internet Growth Potential 424
  14-7b Ethical and Legal Concerns 425
Ethics and Social Responsibility: California Ups the Ante on Privacy Protection 426
  14-7c Future Challenges for Computer Technology, Social Media, and e-Business 427
Summary 428
Key Terms 430
Discussion Questions 430
Case 14: Target's Big Bet on Digital 430
Building Skills for Career Success 431

Chapter 15: Using Management and Accounting Information 433

→ **Inside Business:** What It's Like to Work for the Big Four 434
15-1 How Can Information Reduce Risk When Making a Decision? 435
  15-1a Information and Risk 435
  15-1b Information Rules 436
  15-1c The Difference Between Data and Information 436
  15-1d Knowledge Management 436
Technology and Innovation: The IRS Uses Artificial Intelligence and Technology to Improve Tax Collection 437
15-2 What Is a Management Information System? 438
  15-2a A Firm's Information Requirements 439
  15-2b Costs and Limits of the System 440
15-3 How Do Employees Use a Management Information System? 440
  15-3a Step 1: Collecting Data 441
  15-3b Step 2: Storing Data 441
  15-3c Step 3: Updating Data 441
  15-3d Step 4: Processing Data 442
  15-3e Step 5: Presenting Information 442
15-4 Why Accounting Information Is Important 444
  15-4a Why Audited Financial Statements Are Important 444
Ethics and Social Responsibility: KPMG Caught in Widespread Cheating Scandal 445
  15-4b Accounting Fraud, Ethical Behavior, and Reform 445
  15-4c Different Types of Accounting 446
  15-4d Careers in Accounting 447
Exploring Careers: Forensic Accounting Is on the Rise 448
15-5 The Accounting Equation and the Balance Sheet 448
  15-5a The Accounting Equation 449
  15-5b The Balance Sheet 449
  15-5c Assets 451
  15-5d Liabilities and Owners' Equity 452
Sustaining the Planet: Accountants Grow Concerned About Social and Environmental Issues 453

15-6 The Income Statement 453
    - *15-6a Revenues 454*
    - *15-6b Cost of Goods Sold 455*
    - *15-6c Operating Expenses 456*
    - *15-6d Net Income 456*

15-7 The Statement of Cash Flows 456

15-8 Evaluating Financial Statements 458
    - *15-8a Comparing Financial Data 458*
    - *15-8b Financial Ratios 458*

Summary 461
Key Terms 462
Discussion Questions 462
Case 15: How Larry Ellison and Oracle Plan to Win the Cloud Wars 462
Building Skills for Career Success 463

Chapter 16: Mastering Financial Management 465

→ ***Inside Business:*** Southwest Navigates Financial Management During Pandemic 466

16-1 Why Financial Management? 467
    - *16-1a The Need for Financial Management 468*

Ethics and Social Responsibility: Goldman Sachs Fined Billions for Foreign Bribery 469
    - *16-1b Careers in Finance 469*

16-2 The Need for Financing 470
    - *16-2a Short-Term Financing 470*
    - *16-2b Long-Term Financing 471*
    - *16-2c The Risk–Return Ratio 471*

16-3 Planning—The Basis of Sound Financial Management 472
    - *16-3a Developing the Financial Plan 472*

Exploring Careers: How to Become a CFO 474
    - *16-3b Monitoring and Evaluating Financial Performance 475*

16-4 Financial Services Provided by Banks and Other Financial Institutions 475
    - *16-4a Traditional Banking Services for Business Clients 475*

Technology and Innovation: Mastercard Advances Its Open Banking Strategy 477
    - *16-4b Debit and Credit Card Transactions and Mobile Pay 477*
    - *16-4c Electronic Banking Services 478*
    - *16-4d International Banking Services 479*

16-5 Sources of Short-Term Debt Financing 480
    - *16-5a Sources of Unsecured Short-Term Financing 480*
    - *16-5b Sources of Secured Short-Term Financing 482*
    - *16-5c Factoring Accounts Receivable 483*
    - *16-5d Cost Comparisons 483*

16-6 Sources of Equity Financing 483
    - *16-6a Selling Stock 484*
    - *16-6b Retained Earnings 486*
    - *16-6c Venture Capital, Angel Investors, and Private Placements 486*

Entrepreneurial Success: How Can Small Businesses Secure Financing? 487

16-7 Sources of Long-Term Debt Financing 488
    - *16-7a Long-Term Loans 488*
    - *16-7b Corporate Bonds 489*
    - *16-7c Cost Comparisons 491*

Summary 491
Key Terms 493
Discussion Questions 493
Case 16: DoorDash Delivers An IPO 493
Building Skills for Career Success 495

Running a Business: Part 6: Graeter's Recipe for Growth: New Systems, Social Media, and Financing 496

Building a Business Plan: Part 6 497

Endnotes E-1
Glossary G-1
Name Index NI-1
Subject Index SI-1

The following Online-Only Chapters and Appendices appear on the companion site and within the MindTap Reader:

Online-Only Chapter 17: Understanding Personal Finances and Investments 17-1
Online-Only Chapter 18: Enhancing Union-Management Relations 18-1

Appendix A: Careers in Business A-1
Appendix B: Risk Management and Insurance B-1
Appendix C: Business Law, Regulation, and Taxation C-1

Acknowledgments

The quality of this book and its supplements program has been helped immensely by the insightful and rich comments of a special set of instructors. Their thoughtful and helpful comments had real impact in shaping the final product. We wish to thank:

Ken Anglin, *Minnesota State University, Mankato*
Ellen A. Benowitz, *Mercer County Community College*
Michael Bento, *Owens Community College*
Laura Bulas, *Central Community College, NE*
Brennan Carr, *Long Beach City College*
Paul Coakley, *The Community College of Baltimore County*
Jean Condon, *Mid-Plains Community College*
Mary Cooke, *Surry Community College*
Dean Danielson, *San Joaquin Delta College*
Gary Donnelly, *Casper College*
Karen Edwards, *Chemeketa Community College*
Donna K. Fisher, *Georgia Southern University*
Mark Fox, *Indiana University South Bend*
Connie Golden, *Lakeland Community College*
Karen Gore, *Ivy Tech Community College—Evansville*
John Guess, *Delgado Community College*
Tom Hendricks, *Oakland Community College*
Robert James, *Macomb Community College*
Eileen Kearney, *Montgomery Community College*
Mary Beth Klinger, *College of Southern Maryland*
Natasha Lindsey, *University of North Alabama*
Emilio Lopez, *Dallas College*
Robert Lupton, *Central Washington University*
John Mago, *Anoka Ramsey Community College*
Pamela G. McElligott, *St. Louis Community College Meramec*
Myke McMullen, *Long Beach City College*
Carol Miller, *Community College of Denver*
Diane Minger, *Dallas College*
Jaideep Motwani, *Grand Valley State*
Mark Nagel, *Normandale Community College*
Dyan Pease, *Sacramento City College*
Jeffrey D. Penley, *Catawba Valley Community College*
Angela J. Rabatin, *Prince George's Community College*
Anthony Racka, *Oakland Community College—Auburn Hills Campus*
Dwight Riley, *Dallas College*
Carol Rowey, *Community College of Rhode Island*
Christy Shell, *Houston Community College*
Cindy Simerly, *Lakeland Community College*
Yolanda I. Smith, *Northern Virginia Community College*
Gail South, *Montgomery College*
Rieann Spence-Gale, *Northern Virginia Comm. College—Alexandria Campus*
Kurt Stanberry, *University of Houston, Downtown*
John Striebich, *Monroe Community College*
Keith Taylor, *Lansing Community College*
Tricia Troyer, *Waubonsee Community College*
Leo Trudel, *University of Maine - Fort Kent*
Anne Williams, *Gateway Community College*
Kevin Wortley, *Dallas College*

We want to thank the following people for their professional and technical assistance: Gwyn Walters, Klarisa Posada, Ashley Nguyen, Kelsey Reddick, Brenda Aram, Theresa Kapoor, David Pierce, Kathryn Thumme, Karen Tucker, Dave Kapoor, Susan Fant, and Jeff Penley.

Many talented professionals at Cengage Learning have contributed to the development of *Foundations of Business, 7e*. We are especially grateful to Erin Joyner, Thais Alencar, Joe Sabatino, Heather Thompson, Clara Kuhlman, Allie Janneck, Stephanie Hall, Megan Guiliani, Angela Sheehan, Sara Greenwood, Hannah May, Amanda Ryan, Tony Winslow, Cara Suriyamongkol, and Nick Perez. Their inspiration, patience, support, and friendship are invaluable.

W. M. P.
R. J. H.
J. R. K.

About the Authors

William M. Pride

Texas A&M University

William M. Pride is Professor of Marketing at Mays Business School, Texas A&M University. He received his PhD from Louisiana State University. He is the author of Cengage Learning's *Marketing*, 20th edition, a market leader. Dr. Pride's research interests are in advertising, promotion, and distribution channels.

Dr. Pride's research articles have appeared in major journals in the fields of advertising and marketing, such as *Journal of Marketing*, *Journal of Marketing Research*, *Journal of the Academy of Marketing Science*, and the *Journal of Advertising*. Dr. Pride is a member of the American Marketing Association, Academy of Marketing Science, Society for Marketing Advances, and the Marketing Management Association. Dr. Pride has taught Principles of Marketing and other marketing courses for more than 45 years at both the undergraduate and graduate levels.

Robert J. Hughes

Dallas College - Richland Campus

Robert J. Hughes (EdD, University of North Texas) specializes in business administration and college instruction. He has taught Introduction to Business for more than 35 years both on campus and online for Richland College—one of seven campuses that are part of the Dallas College System. In addition to *Business* and *Foundations of Business*, published by Cengage Learning, he has authored college textbooks in personal finance and business mathematics; served as a content consultant for two popular national television series, *It's Strictly Business* and *Dollars & Sense: Personal Finance for the 21st Century*; and is the lead author for a business math project utilizing computer-assisted instruction funded by the ALEKS Corporation. He is also active in many academic and professional organizations and has served as a consultant and investment advisor to individuals, businesses, and charitable organizations. Dr. Hughes is the recipient of three different Teaching in Excellence Awards at Richland College. According to Dr. Hughes, after 35 years of teaching Introduction to Business, the course is still exciting: "There's nothing quite like the thrill of seeing students succeed, especially in a course like Introduction to Business, which provides the foundation for not only academic courses, but also life in the real world."

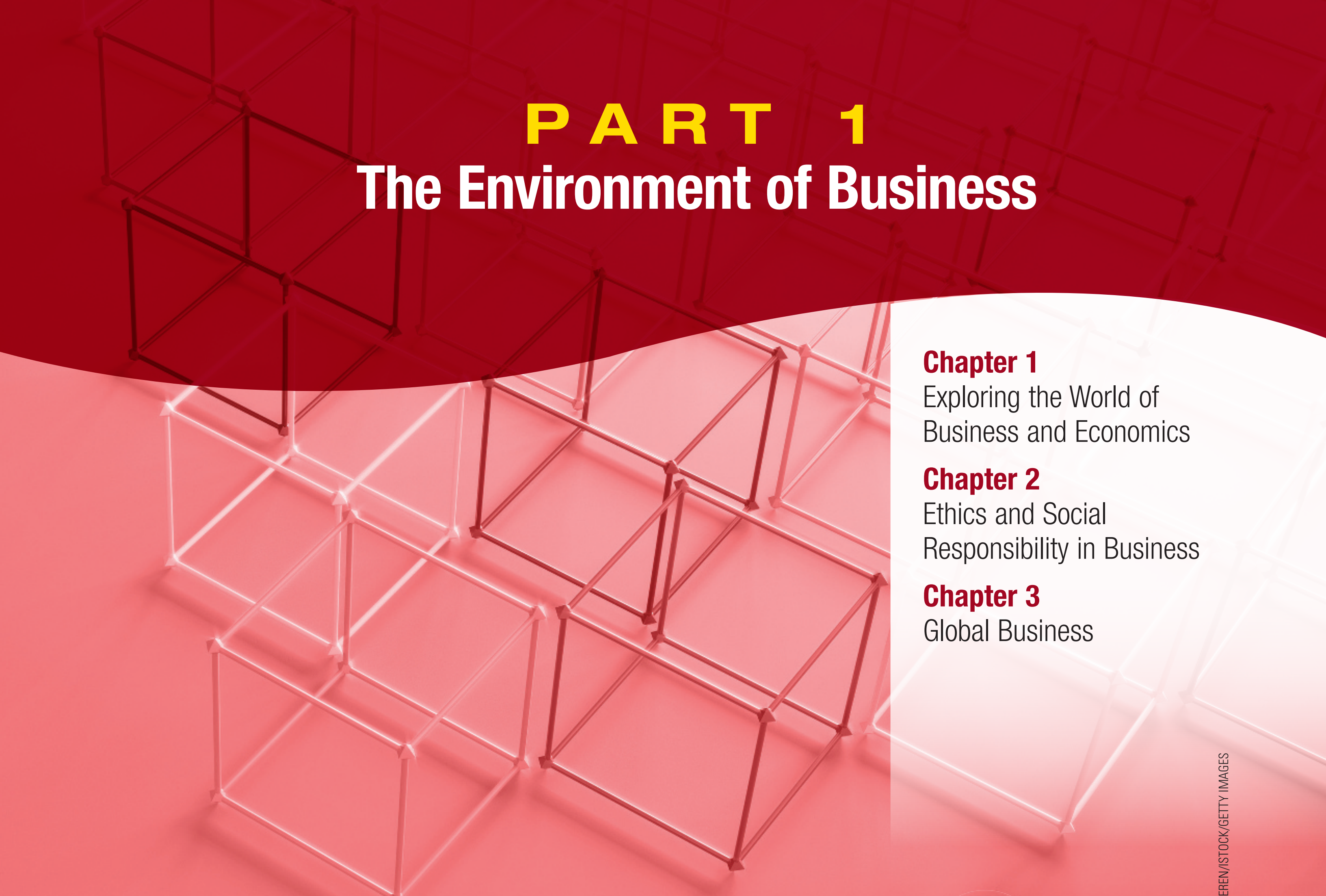
Jack R. Kapoor

College of DuPage

Jack R. Kapoor (EdD, Northern Illinois University) has been a Professor of Business and Economics in the Business and Technology Division at the College of DuPage, where he has taught Introduction to Business, Marketing, Management, Economics, and Personal Finance since 1969. He previously taught at Illinois Institute of Technology's Stuart School of Management, San Francisco State University's School of World Business, and other colleges. Professor Kapoor was awarded the Business and Services Division's Outstanding Professor Award for 1999–2000. He served as an Assistant National Bank Examiner for the U.S. Treasury Department and as an international trade consultant to Bolting Manufacturing Co., Ltd., Mumbai, India.

Dr. Kapoor is known internationally as a coauthor of several textbooks in Business and Personal Finance, including Business MindTap (Cengage Learning), has served as a content consultant for two popular national television series, *Dollars & Sense: Personal Finance for the 21st Century* and *The Business File: An Introduction to Business*, and developed two full-length audio courses in business and personal finance. He has been quoted in many national newspapers and magazines, including *USA Today, U.S. News & World Report*, the *Chicago Sun-Times, Crain's Small Business*, the *Chicago Tribune*, and other publications.

Dr. Kapoor has traveled around the world and has studied business practices in capitalist, socialist, and communist countries.


EONEREN/ISTOCK/GETTY IMAGES

PART 1

The Environment of Business

Chapter 1
Exploring the World of Business and Economics

Chapter 2
Ethics and Social Responsibility in Business

Chapter 3
Global Business

IPOPBA/ISTOCK/GETTY IMAGES

In this part of *Foundations of Business*, we begin by examining the world of business and how the economy affects your life. Next, we discuss ethical and social responsibility issues that affect business firms and our society. Then we explore the increasing importance of international business.

Chapter

1

MONKEY BUSINESS IMAGES/SHUTTERSTOCK.COM

Exploring the World of Business and Economics

Why Should You Care?

Studying business will help you choose a career, become a successful employee or manager, start your own business, and become a more informed consumer and better investor.

Learning Objectives

Once you complete this chapter, you will be able to:

1-1 Discuss what you must do to be successful in today's business world.

1-2 Identify the potential risks and rewards of business.

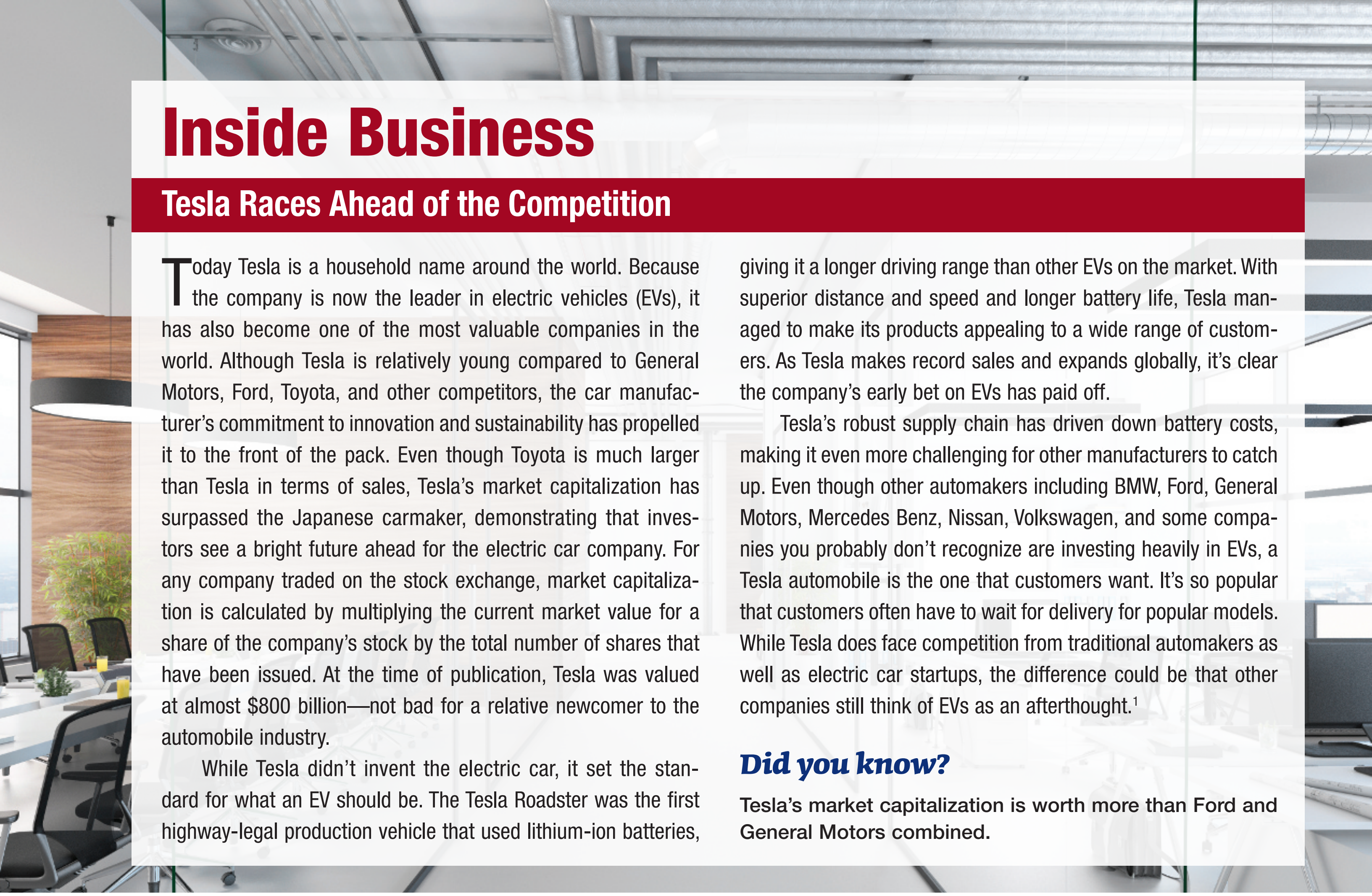
1-3 Describe the two types of economic systems: capitalism and command economy.

1-4 Identify the ways to measure economic performance.

1-5 Examine the different phases in the typical business cycle.

1-6 Outline the four types of competition.

1-7 Summarize the development of American business and the challenges that businesses and society will encounter in the future.



Inside Business

Tesla Races Ahead of the Competition

Today Tesla is a household name around the world. Because the company is now the leader in electric vehicles (EVs), it has also become one of the most valuable companies in the world. Although Tesla is relatively young compared to General Motors, Ford, Toyota, and other competitors, the car manufacturer's commitment to innovation and sustainability has propelled it to the front of the pack. Even though Toyota is much larger than Tesla in terms of sales, Tesla's market capitalization has surpassed the Japanese carmaker, demonstrating that investors see a bright future ahead for the electric car company. For any company traded on the stock exchange, market capitalization is calculated by multiplying the current market value for a share of the company's stock by the total number of shares that have been issued. At the time of publication, Tesla was valued at almost $800 billion—not bad for a relative newcomer to the automobile industry.

While Tesla didn't invent the electric car, it set the standard for what an EV should be. The Tesla Roadster was the first highway-legal production vehicle that used lithium-ion batteries, giving it a longer driving range than other EVs on the market. With superior distance and speed and longer battery life, Tesla managed to make its products appealing to a wide range of customers. As Tesla makes record sales and expands globally, it's clear the company's early bet on EVs has paid off.

Tesla's robust supply chain has driven down battery costs, making it even more challenging for other manufacturers to catch up. Even though other automakers including BMW, Ford, General Motors, Mercedes Benz, Nissan, Volkswagen, and some companies you probably don't recognize are investing heavily in EVs, a Tesla automobile is the one that customers want. It's so popular that customers often have to wait for delivery for popular models. While Tesla does face competition from traditional automakers as well as electric car startups, the difference could be that other companies still think of EVs as an afterthought.[1]

Did you know?

Tesla's market capitalization is worth more than Ford and General Motors combined.

Wow! What a challenging world we live in. Just for a moment, think about how the world has changed in the last few years. The United States has experienced a pandemic, non-essential businesses were closed in many states, the unemployment rate increased, and the stock market took a nosedive and then recovered all in a short period of time. Even though the economy has shown signs of improvement, there are still problems and many people worry about the future of the nation and the economy. Simply put, many individuals, business leaders, and politicians worry that the future of the nation's economy could be a bumpy road that leads to another recession.

Regardless of the current state of the economy, keep in mind that our economy continues to adapt and change to meet the challenges of an ever-changing world and to provide opportunities for those who want to achieve success. Our economic system also provides an amazing amount of freedom that allows businesses like Tesla—the company profiled in the Inside Business opening case for this chapter—to adapt to satisfy the needs of customers. To meet increased consumer demands for an electric automobile, the company's managers, engineers, and employees were able to design and build an automobile that consumers really wanted. After initial success, Tesla—a newcomer in the automobile industry—continues to innovate and create new models with self-driving capability. As a result, the company is now profitable and is one of the most valuable companies in the world.

Within certain limits, imposed mainly to ensure public safety, the owners of a business can produce any legal good or service they choose and attempt to sell it at the price they set. This system of business, in which individuals decide what to produce, how to produce it, and at what price to sell it, is called **free enterprise**. Our free-enterprise system ensures, for example, that Amazon.com can sell everything from books, televisions, and toys to computers, cameras, and clothing. Our system gives Amazon's owners and stockholders the right to make a profit from the company's success. It gives Amazon's management the right to compete with bookstore rival Barnes & Noble and retailers Walmart, Best Buy, and Macy's. It also gives you—the consumer—the right to choose.

In this chapter, we look briefly at what business is and how it became that way. First, we discuss what you must do to be successful in the world of business and explore some important reasons for studying business. Second, we define *business*, noting how business organizations satisfy their customers' needs and earn profits. Third, we examine how capitalism and command economies answer four basic economic questions. Next, our focus shifts to how the nations of the world measure economic performance, the phases in a typical business cycle, and the four types of competitive situations. Finally, we look at the events that helped shape today's business system, the current business environment, and the challenges that businesses face.

1-1 Your Future in the Changing World of Business

Learning Objective

1-1 Discuss what you must do to be successful in today's business world.

The key word in this heading is *changing*. When faced with the COVID-19 pandemic that raced through the world, small business owners, employees, managers, and investors began to ask the question: What effect will non-essential business closures and record high unemployment rates have on the economy? More specifically, many people wanted to know, how does this affect me both now and in the future? Although this is a fair question, it is difficult to answer. For an employee just starting a career or for a college student preparing for a career, the question is even more difficult to answer. Now, as the United States and the world adjust to life after the COVID-19 pandemic and the economy shows signs of recovery, there are opportunities out there for people who are willing to work hard, continue to learn, and possess the ability to adapt to change. Let's begin this course with three basic concepts.

- What do you want?
- Why do you want it?
- Write it down!

Joe Dudley, one of the world's most respected Black business owners, offers the preceding advice to anyone who wants to succeed in business. His advice can help you achieve success. What is so amazing about Dudley's success is that he started a manufacturing business in his own kitchen, with his wife and children serving as the new firm's only employees. He went on to develop his own line of haircare and cosmetic products sold directly to cosmetologists, barbers, beauty schools, and consumers in the United States and in foreign countries. Today, after a lot of hard work and a strong work ethic, Mr. Dudley has built a well-recognized and respected company in the competitive cosmetics industry. He is not only a successful business owner but also a winner of the Horatio Alger Award—an award given to outstanding individuals who have succeeded in the face of adversity.[2]

Although many people would say that Joe Dudley was just lucky or happened to be in the right place at the right time, the truth is that he became a success because he had a dream and worked to turn the dream into a reality. He would be the first to tell you that you have the same opportunities he had. According to Mr. Dudley, "Success is a journey, not just a destination."[3]

free enterprise the system of business in which individuals are free to decide what to produce, how to produce it, and at what price to sell it

Whether you want to obtain part-time employment to pay college and living expenses, begin your career as a full-time employee, or start a business, you must bring something to the table that makes you different from the next person. Employers and our economic system are more demanding than ever before. Ask yourself: What can I do that will make employers want to pay me a salary? What skills do I have that employers need? With these two questions in mind, we begin the next section with another basic question: Why study business?

1-1a **Why Study Business?**

The potential benefits of higher education are enormous. To begin with, there are economic benefits. Over their lifetimes, college graduates on average earn much more than high school graduates. Although lifetime earnings are substantially higher for college graduates, so are annual income amounts (refer to Figure 1-1). In addition to higher income, you will find at least four compelling reasons for studying business.

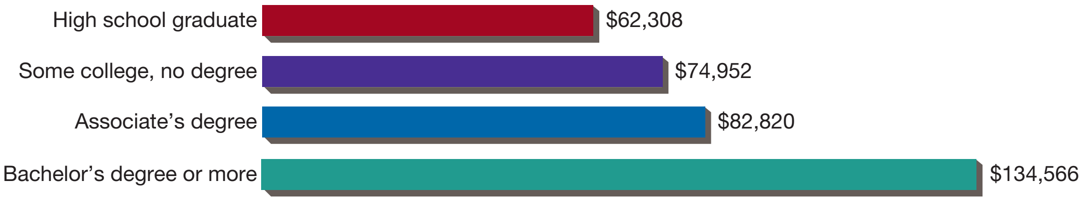
For Help in Choosing a Career What do you want to do with the rest of your life? Like many people, you may find it a difficult question to answer. This business course will introduce you to a wide array of employment opportunities. In private enterprise, these range from small, local businesses owned by one individual to large companies such as American Express and Microsoft owned by thousands of stockholders. There are also employment opportunities with federal, state, county, and local governments and with charitable organizations such as Habitat for Humanity, the Red Cross, and Save the Children. For help in deciding which career might be right for you, read Appendix A "Careers in Business," which appears on the text website.

In addition to career information in Appendix A, a number of websites provide information about career development. To click your career into high gear, you can also use online networking. Websites like Facebook, Twitter, LinkedIn, and other social media sites can help you locate job openings and help prospective employers to find you. To make the most of online networking, begin by identifying and joining sites where you can connect with potential employers, former classmates, and others who may have or may hear of job openings. Next, be sure your online profile, photographs, and posts communicate your abilities and interests. Finally, be ready to respond quickly when you spot a job opening.

One thing to remember as you think about what your ideal career might be is that people often choose a career that is a reflection of what they value and consider most important. What will give one individual personal satisfaction may not satisfy another. For example, one person may dream of a career as a successful corporate executive with a large salary and job security in marketing or technology or financial services. Another person may choose a career that has more modest monetary rewards but that provides the opportunity to help others. What you choose to do with your life will be based on what you feel is most important. And *you* are a very important part of that decision.

Figure 1-1 **Who Makes the Most Money?**

Education makes a difference. Dollar amounts represent the average annual salary for full-time workers in each household.



Source: "Educational Attainment of Householder—Households with Householder 25 Years Old and Over by Median and Mean Income," The U.S. Census Bureau at www.census.gov (accessed January 7, 2021).

Exploring Careers

Gen Z Seeks Workplace Diversity

When it comes to finding the perfect employer, Generation Z (people born between 1997 and 2012) prioritizes workplace diversity. According to a survey by Tallo, an online platform for students and job seekers, nearly 70 percent say they would be more likely to accept a job offer if the recruiters and materials representing the company were ethnically and racially diverse. In fact, some would even decline a job offer if the firm fell short on these factors. Workplace diversity—the differences among people in a workforce owing to factors such as age, race, ethnicity, gender, sexual orientation, and ability—is a top priority for Gen Z.

Gen Z—the most diverse generation ever—has surpassed Millennials (people born between 1981 and 1996) to become the largest generation. The effects of their entry into the workplace are already felt by companies around the world. Diversity for Gen Z goes beyond race and gender to encompass gender identity and orientation. Nearly 90 percent of those surveyed said they believe employers should ask potential employees about their identified pronouns, a practice that is not yet widespread.

Companies that reflect diversity, equity, and inclusion in their branding and marketing materials will be more likely to attract fresh talent. Firms should be prepared to embed these values at the heart of the organization rather than making surface-level claims. With Gen Z on the hunt for organizations that reflect their values and beliefs, the burden is on employers to prioritize diversity issues.

Sources: Based on information in Tamara E. Holmes, “Diverse Workforce a Top Draw for Nearly 7 in 10 Members of Generation Z,” *Yahoo Finance*, November 4, 2020, finance.yahoo.com/news/diverse-workforce-top-draw-nearly-175929234.html; Deloitte, “Understanding Generation Z in the Workplace,” www2.deloitte.com/us/en/pages/consumer-business/articles/understanding-generation-z-in-the-workplace.html; Sheryl Estrada, “Workplace D&I in 2021 Will Keep External Community in Mind,” *HR Dive*, January 13, 2021, www.hrdive.com/news/workplace-di-in-2021-will-keep-external-community-in-mind/593297/.

To Be a Successful Employee Deciding on the type of career you want is only the first step. To get a job in your chosen field and to be successful at it, you will have to develop a plan, or a road map, that ensures you have the skills and knowledge the job requires. Think about what you’d look for if you were hiring an employee and strive to be that kind of person. You will also be expected to have the ability to work well with many types of people in a culturally diverse workforce. **Cultural (**or **workplace) diversity** refers to a system that recognizes and respects the differences among people because of their age, race, ethnicity, gender, sexual orientation, and ability.

This course and the other college courses you take, your instructors, and all of the resources available at your college or university can help you acquire the skills and knowledge you will need for a successful career. But don’t underestimate your part in making your dream a reality. In addition to job-related skills and knowledge, employers will also look for the following characteristics when hiring a new employee or promoting an existing employee:

- Honesty and integrity
- Willingness to work hard
- Dependability
- Time management skills
- Self-confidence
- Motivation
- Willingness to learn
- Communication skills
- Professionalism

cultural (or **workplace) diversity** a system that recognizes and respects the differences among people because of their age, race, ethnicity, gender, sexual orientation, and ability

Success
Ahead

JOSEFSDAVE/SHUTTERSTOCK.COM

The road to success can take many different paths! While many people want immediate success, it's important to chart a path that leads to life-long success. It helps to remember what Joe Dudley, the founder of Dudley Beauty Products said: "Success is a journey, not just a destination."

Employers will also be interested in any work experience you may have had in cooperative work/school programs, during summer vacations, or in part-time jobs during the school year. Experience—even part-time work experience—can make a difference when it is time to apply for the job you really want.

Many employees want to become managers because managers often receive higher salaries and can earn promotions within an organization. To be effective, managers must be able to perform four basic management functions: planning, organizing, leading and motivating, and controlling. All four topics are discussed in Chapter 6, Understanding the Management Process. To successfully perform these management functions, managers must also be able to work effectively with individual employees, other managers within the firm, and people outside the firm. In addition to the four management functions just mentioned, a successful manager will need many of the same characteristics that an employee needs to be successful.

To Start Your Own Business Some people prefer to work for themselves, and they open their own businesses. To be successful, business owners must possess many of the same characteristics that successful employees and managers have, and they must be willing to work hard and put in long hours.

It also helps if a small-business owner has an idea that will provide a product or service that customers want. At the age of 16, Palmer Luckey began building virtual reality headsets in his garage after school and work. While the first prototypes based on his ideas were crude by today's standards, the product showed a great deal of promise. After further development, refinements, and more ideas, the product—now called Oculus—was a success in the marketplace. How successful? Answer: so successful that Facebook paid $2 billion to acquire the company.[4]

Unfortunately, many business firms fail. In fact, only about 50 percent survive the first five years. Typical reasons for business failures include undercapitalization (not enough money), poor business location, poor customer service, unqualified or untrained employees, fraud, lack of a proper business plan, and failure to seek outside professional help. The material in this course will help you to overcome many of these problems. The material in Chapter 5, Small Business, Entrepreneurship, and Franchises, and selected topics and examples throughout this text will also help you to decide whether you want to open your own business.

To Become a Better Informed Consumer and Investor The world of business surrounds us. You cannot buy a home, a new Ford Escape Hybrid from the local Ford dealer, a pair of jeans at Gap Inc., or a hot dog from a street vendor without entering into a business transaction. Because you no doubt will engage in business transactions almost every day of your life, one very good reason for studying business is to become a more fully informed consumer.

Many people also rely on a basic understanding of business to help them invest for the future. According to Julie Stav, Hispanic stockbroker turned radio and YouTube personality and the author of *Get Your Share: A Guide to Striking It Rich in the Stock Market* and other personal finance help books, it is important to learn the basics about the economy and business, stocks, mutual funds, and other alternatives before investing your money. She also believes that it is never too early to start investing.[5] Although this is an obvious conclusion, just dreaming of being rich does not make it happen. In fact, like many facets of life, it takes planning and determination to establish the type of investment program that will help you accomplish your financial goals.

1-1b **Special Note to Business Students**

It is important to begin reading this text with one thing in mind: *This business course does not have to be difficult.* We have done everything possible to eliminate the problems that you encounter in a typical class. All of the features in each chapter have been evaluated and recommended by instructors with years of teaching experience. In addition, business students—just like you—were asked to critique each chapter component. Based on this feedback, the text includes the following features:

- *Learning objectives* appear at the beginning of each chapter.
- *Inside Business* is a chapter-opening case that highlights how successful, real-world companies do business on a day-to-day basis.
- *Margin notes* are used throughout a chapter to reinforce both learning objectives and key terms.
- *Boxed features* in each chapter highlight how managers, employees, and entrepreneurs can be both ethical and successful. Topics discussed in the boxed features include ethics and social responsibility, suggestions for entrepreneurs, technology and innovation, environmental issues, and exploring different career options.
- *Concept Checks* at the end of each major section within a chapter help you test your understanding of the main issues just discussed.
- *End-of-chapter materials* provide a chapter summary, a list of key terms, discussion questions, and a case about a successful, real-world company.
- The last section of every chapter is entitled *Building Skills for Career Success* and includes exercises devoted to enhancing your social media skills, building team skills, and researching different careers.
- *End-of-part materials* provide a continuing case about Graeter's Ice Cream, a company that operates a chain of retail outlets in the Cincinnati, Ohio, area and sells to Kroger Stores and other retailers and consumers throughout the country. Also, at the end of each major part is an exercise designed to help you develop the components included in a typical business plan.

We've worked hard to make sure this edition reflects what is happening in the world and our nation. We wanted you to know how changes in the economy and world events, and yes, even a pandemic can impact not only business, but also you as a student and a consumer. Just as important, we wanted to create a text and student learning materials that help you be successful.

Live your dream!

ZERBOR/SHUTTERSTOCK.COM

Because a text should always be evaluated by the students and professors who use it, we would welcome and sincerely appreciate your comments and suggestions. Please feel free to contact us by using one of the following e-mail addresses:

Bill Pride: w-pride@tamu.edu
Bob Hughes: Hughespublishing@outlook.com
Jack Kapoor: kapoorj@att.net

✓ Concept Check

- What reasons would you give if you were advising someone to study business?
- What factors affect a person's choice of careers?
- Once you have a job, what steps can you take to be successful?

1-2 Business: A Definition

Learning Objective

1-2 Identify the potential risks and rewards of business.

Business is the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs. The general term *business* refers to all such efforts within a society (as in "American business"). However, *a business* is a particular organization, such as a Kroger grocery store or a Cracker Barrel Old Country Store. To be successful, a business must perform three activities. It must be organized, it must satisfy needs, and it must earn a profit.

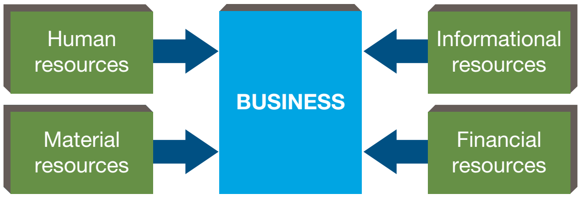
1-2a The Organized Effort of Individuals

For a business to be organized, it must combine four kinds of resources: material, human, financial, and informational. *Material* resources include the raw materials used in manufacturing processes. For example, Mrs. Fields Cookies needs flour, sugar, butter, eggs, and other raw materials to produce the food products it sells worldwide. Material resources can also include buildings and machinery—sometimes referred to as the capital resources needed to produce goods and services. In addition, a company needs human, financial, and informational resources. *Human* resources are the people who furnish their labor to the business in return for wages. The *financial* resource is the money required to pay employees, purchase materials, and generally keep the business operating. *Information* is the resource that tells the managers of the business how effectively the other three resources are being combined and used (refer to Figure 1-2).

Today, businesses are usually organized as one of three specific types. *Service businesses* produce services, such as haircuts, legal advice, or tax preparation. H&R Block provides tax preparation and software and digital products to both businesses and consumers in the United States and around the world. *Manufacturing businesses* process various material resources into tangible goods, such as automobiles and trucks, clothing, or computers. Intel, for example, produces computer chips and other technology components that, in turn, are sold to companies that manufacture computers. Finally, some firms called *marketing intermediaries* buy products from manufacturers and then resell them. Sony Corporation is a manufacturer that produces stereo equipment, televisions, cameras, and other electronic products. These products may be sold to a marketing intermediary—often referred to as a retailer—such as Best Buy or Walmart, which then resells the manufactured goods to consumers in their retail stores.

Figure 1-2 Combining Resources

A business must combine all four resources effectively to be successful.



business the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs

While most people think of retailers as the "store around the corner," today many consumers prefer to shop online. For example, there was a dramatic increase in the number of customers shopping online during the COVID-19 pandemic. While people still needed food, cleaning supplies, toilet paper, and other essential items, they were afraid to venture out to shop at local retailers because of the fear of contracting the virus. As an alternative, they used the internet to order merchandise online and then had their purchases delivered to their home or used "curbside" delivery. As a result, major retailers including Walmart, Amazon, Target, Home Depot, Lowe's, and smaller retailers saw increases in the number of online sales.

To take advantage of the opportunities to sell goods and services online, there are retailers that exist only on the internet and more traditional business firms that sell goods and services in both their brick-and-mortar stores *and* online. For example, Etsy is a highly successful internet retailer. The secret of Etsy's success is that the company provides an online site for buyers looking for unique or custom-made items not found in typical retail stores. Macy's, on the other hand, sells merchandise in both its stores and online. For our purposes, **e-business** can be defined as the organized effort of individuals to produce and sell for a profit, the goods and services that satisfy society's needs *through the facilities available on the internet*. While very similar to the definition of business, an e-business is different because of the last seven words—*through the facilities available on the internet*. e-Business—a topic we will continue to explore throughout this text—has become an accepted method of conducting business and a way for businesses to increase sales and profits and reduce expenses.

1-2b Satisfying Needs

The ultimate objective of every firm must be to satisfy the needs of its customers. People generally do not buy goods and services simply to own them; they buy goods and services to use them in order to satisfy their particular needs. In fact, a large number of start-up businesses fail because customers don't need or want what the business is selling. Many experts suggest that talking to customers to determine what needs they have is an essential step that many would-be business owners ignore. In other situations, would-be business owners don't consider if competitors are already meeting the needs of customers in a specific geographic area. Even an

e-business the organized effort of individuals to produce and sell for a profit, the goods and services that satisfy society's needs *through the facilities available on the internet*

SENDA BLDG.
7 ELEVEN
SIM
TAX FREE SHOP
ATM

Oh, thank heaven for 7-Eleven!® **This 7-Eleven store in Osaka, Japan, is just one convenience store, but it is part of a company that has over 70,000 stores in 17 different countries. Started in 1927, today 7-Eleven is the largest chain of convenience stores in the world and is built on a basic principle: "Give the customers what they want, when and where they want it."**

NP27/SHUTTERSTOCK.COM

existing business can fail if it doesn't adapt to changing customer needs and its products or services no longer meet customer needs.

Different people have different needs. Some of us may feel the need for transportation is best satisfied by an air-conditioned BMW with navigation system, turbo V8 engine, stereo system, heated and cooled seats, automatic transmission, power windows, and remote-control side mirrors. Others may believe that a Chevrolet Spark with a four-cylinder engine and manual transmission will do just fine. Both products are available to those who want them, along with a wide variety of other products that satisfy the need for transportation.

When businesses understand their customers' needs and work to satisfy those needs, they are usually successful. Back in 1962, Sam Walton opened his first discount store in Rogers, Arkansas. Although the original store was quite different from the Walmart superstores you see today, the basic ideas of providing customer service and offering goods that satisfied needs at low prices are part of the reason why this firm has grown to become the largest retailer in the world.

1-2c **Business Profit**

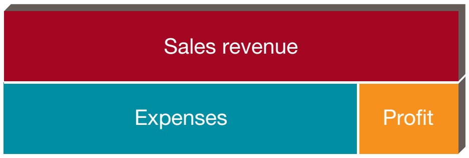
A business receives money (sales revenue) from its customers in exchange for goods or services. It must also pay out money to cover the expenses involved in doing business. If the firm's sales revenues are greater than its expenses, it has earned a profit. More specifically, as shown in Figure 1-3, **profit** is what remains after all business expenses have been deducted from sales revenue.

A negative profit, which results when a firm's expenses are greater than its sales revenue, is called a *loss*. A business cannot continue to operate at a loss for an indefinite period of time. Management and employees must find some way to increase sales revenues and reduce expenses to return to profitability. If some specific actions are not taken to eliminate losses, a firm may be forced to close its doors or file for bankruptcy protection. For example, many businesses including JCPenney, Neiman Marcus, J. Crew, and Hertz were forced to file bankruptcy in 2020 because each firm had lower sales revenues and experienced a loss caused by the COVID-19 pandemic. Fortunately, many of the firms that filed for bankruptcy protection were able to reorganize and continue to operate.

Although many people—especially stockholders and business owners—believe that profit is literally the bottom line or most important goal for a business, many stakeholders may be just as concerned about a firm's social responsibility and environmental record. The term **stakeholders** is used to describe all the different people or groups of people who are affected by an organization's policies, decisions, and activities. Many corporations, for example, are careful to point out their efforts to sustain the planet, participate in the green ecological movement, and help people to live better lives in an annual social responsibility report. In its latest report, General Mills describes how it contributed over $93 million in 2019 (the last year that complete statistics are available) to a wide variety of charitable causes, including support for programs that feed the hungry and for nonprofit organizations, schools, and communities in the United States and around the globe.[6]

Figure 1-3 **The Relationship Between Sales Revenue and Profit**

Profit is what remains after all business expenses have been deducted from sales revenue.



profit what remains after all business expenses have been deducted from sales revenue

stakeholders all the different people or groups of people who are affected by an organization's policies, decisions, and activities

The profit earned by a business becomes the property of its owners. Thus, in one sense, profit is the reward business owners receive for producing goods and services that customers need and want. Profit is also the payment that business owners receive for assuming the considerable risks of business ownership. One of these is the risk of not being paid. Everyone else—employees, suppliers, and lenders—must be paid before the owners.

A second risk that owners must consider is the risk of losing whatever they have invested into the business. A business that cannot earn a profit is very likely to fail, in which case the owners lose whatever money, effort, and time they have invested.

To satisfy society's needs and make a profit, a business must operate within the parameters of a nation's economic system. In the next section, we define economics and describe two different types of economic systems.

✓ Concept Check

- Describe the four resources that must be combined to organize and operate a business.
- What is the difference between a manufacturing business, a service business, and a marketing intermediary?
- Explain the relationship among profit, business risk, and the satisfaction of customers' needs.

1-3 Types of Economic Systems

Learning Objective

1-3 Describe the two types of economic systems: capitalism and command economy.

Economics is the study of how wealth is created and distributed. By *wealth*, we mean "anything of value," including the goods and services produced and sold by business. *How wealth is distributed* simply means "who gets what." Experts often use economics to explain the choices we make and how these choices change as we cope with the demands of everyday life. In simple terms, individuals, businesses, governments, and society must make decisions that reflect what is important to each group at a particular time. For example, suppose you want to take a weekend trip to some exotic vacation spot, and you also want to begin an investment program. Because of your financial resources, though, you cannot do both, so you must decide what is most important. Business firms, governments, and to some extent society face the same types of decisions. Each group must deal with scarcity when making important decisions. In this case, *scarcity* means "lack of resources"—money, time, natural resources, and so on—that are needed to satisfy a want or need.

Today, experts often study economic problems from two different perspectives: microeconomics and macroeconomics. **Microeconomics** is the study of the decisions made by individuals and businesses. Microeconomics, for example, examines how the prices of homes affect the number of homes individuals will buy. On the other hand,

economics the study of how wealth is created and distributed

microeconomics the study of the decisions made by individuals and businesses

Who owns Dairy Queen? There's a chance you've purchased shakes or burgers at DQ, but do you know who owns the restaurant chain? The restaurant chain is part of a multinational corporation—Berkshire Hathaway—a company that owns dozens and dozens of successful companies and was started by Warren Buffett. Today Berkshire Hathaway *and* Dairy Queen meet customer needs, earn profits, and employ thousands of employees because they thrive in a nation with a capitalistic economy.

DQ
Grill & Chill
DQ
Grill & Chill
Blizzard

JONATHAN WEISS/SHUTTERSTOCK.COM

macroeconomics is the study of the national economy and the global economy. Macroeconomics examines the economic effect of national income, unemployment, inflation, taxes, government spending, interest rates, and similar factors on a nation and society.

The decisions that individuals, business firms, government, and society make, and the way in which people deal with the creation and distribution of wealth determine the kind of economic system, or **economy**, that a nation has.

Over the years, the economic systems of the world have differed in essentially two ways: (1) the ownership of the factors of production and (2) how they answer four basic economic questions that direct a nation's economic activity.

Factors of production are the inputs and resources used to produce goods and services. There are four such factors:

- *Land and natural resources*—elements that can be used in the production process to make appliances, automobiles, and other products. Typical examples include crude oil, forests, minerals, land, water, and even air.
- *Labor*—the time and effort that we use to produce goods and services. It includes human resources—people with skills, knowledge, training, and experiences. Examples include managers and employees.
- *Capital*—facilities, equipment, machines, tools, and man-made items used in the production of goods and services and the operation of businesses. For example, the manufacturing equipment in a Pepperidge Farm production facility or a computer used in the corporate offices of McDonald's are both types of capital. Although most people think of money as capital, it is not one of the basic four factors of production because it is a financial resource used to obtain the factors of production necessary to conceptualize, create, and produce goods and services.
- *Entrepreneurship*—the activity that conceptualizes, creates, and organizes land and natural resources, labor, and capital. It is the willingness to take risks and the knowledge and ability to use the other factors of production efficiently. An **entrepreneur** is a person who risks time, effort, and money to start and operate a business.

A nation's economic system determines how the factors of production are used to meet the needs of society. Today, two different economic systems exist: capitalism

macroeconomics the study of the national economy and the global economy

economy the way in which people deal with the creation and distribution of wealth

factors of production inputs and resources used to produce goods and services

entrepreneur a person who risks time, effort, and money to start and operate a business

ZHENGZAISHURU/SHUTTERSTOCK.COM

Is this so-much hot air? No, not really. Fueled by environmental concerns, more and more businesses in industrialized nations are using wind and solar power for their energy needs. Today both wind and solar power are sources of clean and cost-effective energy leading some experts to suggest there's a new natural resource in town.

Entrepreneurial Success

The Next Wave of Entrepreneurs Is Here

During the COVID-19 pandemic, the United States experienced the highest unemployment rate since 1929, and that indirectly led to a boom in entrepreneurship. Based on data from the U.S. Census Bureau, new business formations during the pandemic jumped dramatically, reaching a record high.

Since business creation has historically declined during periods of recession, professionals are optimistic about this new wave of entrepreneurship. The sharp increase in applications to form businesses also suggests that the labor market will recover more quickly from the COVID-19 recession than the Great Recession of 2008. After all, new, successful businesses will need to hire employees.

Recessions often give rise to new types of businesses as innovative entrepreneurs capitalize on new opportunities. The Great Recession of 2008, for example, gave birth to the gig economy as unemployed individuals looked for temporary, flexible, or freelance jobs for alternative ways to make money. Apps like Airbnb and Uber became immensely popular. Now, consumer demand suggests several products and services such as home improvement, pet products, home beauty products, gaming, and fitness and health that may offer new business opportunities to meet the needs of customers.

The COVID-19 pandemic disrupted business operations, shifted consumer behavior, and created new opportunities. As a result, entrepreneurs will have to look outside the box to match customer needs with their internal core strengths. As new start-ups emerge, only time will tell which ones will enjoy long-term success.

Sources: Based on information in Michael Sasso and Alexandre Tanzi, "Covid Recession Spawning Entrepreneurs in U.S. Amid Joblessness," *Bloomberg*, October 14, 2020, www.bloomberg.com/news/articles/2020-10-14/covid-recession-spawning-entrepreneurs-in-u-s-amid-joblessness; Adam Singolda, "Op-Ed: Analysis of 8 Billion Page Views Shows Where the Next Hot Start-up Can Thrive," *CNBC*, May 12, 2020, www.cnbc.com/2020/05/12/here-are-the-new-businesses-to-start-during-the-coronavirus-recession.html; Dr. Anthony M. Criniti, IV, "How to Become a Successful Entrepreneur During the Pandemic," *The Entrepreneur*, July 28, 2020, https://www.entrepreneur.com/article/353674.

---

and command economies. The way each system answers the four basic economic questions listed below determines which type of economy a nation has.

1. *What* goods and services—and how much of each—will be produced?
2. *How* will these goods and services be produced?
3. *For whom* will these goods and services be produced?
4. *Who* owns and who controls the major factors of production?

1-3a **Capitalism**

Capitalism is an economic system in which individuals own and operate the majority of businesses that provide goods and services. Capitalism stems from the theories of the Scottish economist Adam Smith. In his book *Wealth of Nations*, published in 1776, Smith argued that a society's interests are best served when the individuals within that society are allowed to pursue their own self-interest. According to Smith, when individuals act to improve their own fortunes, they indirectly promote the good of their community and the people in that community. Smith went on to call this concept the "invisible hand." The **invisible hand** is a term created by Adam Smith to describe how an individual's own personal gain benefits others and a nation's economy. For example, the only way a small-business owner who produces shoes can increase personal wealth is to sell shoes to customers. To become even more prosperous, the small-business owner must hire workers to produce even more shoes. According to the invisible hand, people in the small-business owner's community not only would have shoes but also would have jobs working for the shoemaker. Thus, the success of people in the community and, to some extent, the nation's economy are tied indirectly to the success of the small-business owner.

capitalism an economic system in which individuals own and operate the majority of businesses that provide goods and services

invisible hand a term created by Adam Smith to describe how an individual's personal gain benefits others and a nation's economy

Adam Smith's capitalism is based on the following fundamental issues—also refer to Figure 1-4.

1. The creation of wealth is the concern of private individuals, not the government.
2. Individuals must own private property and the resources used to create wealth.
3. Economic freedom ensures the existence of competitive markets that allow both sellers and buyers to enter and leave the market as they choose.
4. The role of government should be limited to providing defense against foreign enemies, ensuring internal order, and furnishing public works and education.

One factor that Smith felt was extremely important was the role of government. He believed that government should act only as rule maker and umpire. The French term *laissez-faire* describes Smith's capitalistic system and implies that there should be no government interference in the economy. Loosely translated, this term means "let them do" (as they choose).

Adam Smith's laissez-faire capitalism is also based on the concept of a market economy. A **market economy** (sometimes referred to as a *free-market economy*) is an economic system in which businesses and individuals decide what to produce and buy, and the market determines prices and quantities sold. In today's competitive world, a business like Ford Motor Company must decide *what* type of automobiles it will sell, *how* the automobiles will be produced, and *for whom* the automobiles will be produced. *You,* the consumer, must decide if you will buy a Ford product or an automobile manufactured by another company. Prices are determined by the interaction of consumers and businesses in the marketplace.

1-3b Capitalism in the United States

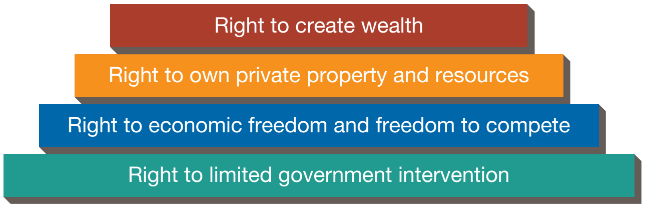
Our economic system is rooted in the laissez-faire capitalism of Adam Smith. However, our real-world economy is not as laissez-faire as Smith would have liked because government participates as more than umpire and rule maker. Our economy is, in fact, a **mixed economy**, one that exhibits elements of both capitalism and socialism.

In a mixed economy, the four basic economic questions discussed at the beginning of this section (*what, how, for whom,* and *who*) are answered through the interaction of households, businesses, and governments. The interactions among these three groups are shown in Figure 1-5.

Households Households, made up of individuals, are the consumers of goods and services as well as owners of some of the factors of production. As *resource owners,* people should be free to determine how their resources are used and also to enjoy the income and wages, rents, interest, and other benefits derived from ownership of their resources. For example, members of households provide businesses with labor. In return, businesses pay wages, which households receive as income.

As *consumers,* household members spend their income to purchase the goods and services produced by business. Today, almost 70 percent of our nation's total production consists of **consumer products**—goods and services purchased by

Figure 1-4 Basic Assumptions of Adam Smith's Laissez-Faire Capitalism


Right to create wealth
Right to own private property and resources
Right to economic freedom and freedom to compete
Right to limited government intervention

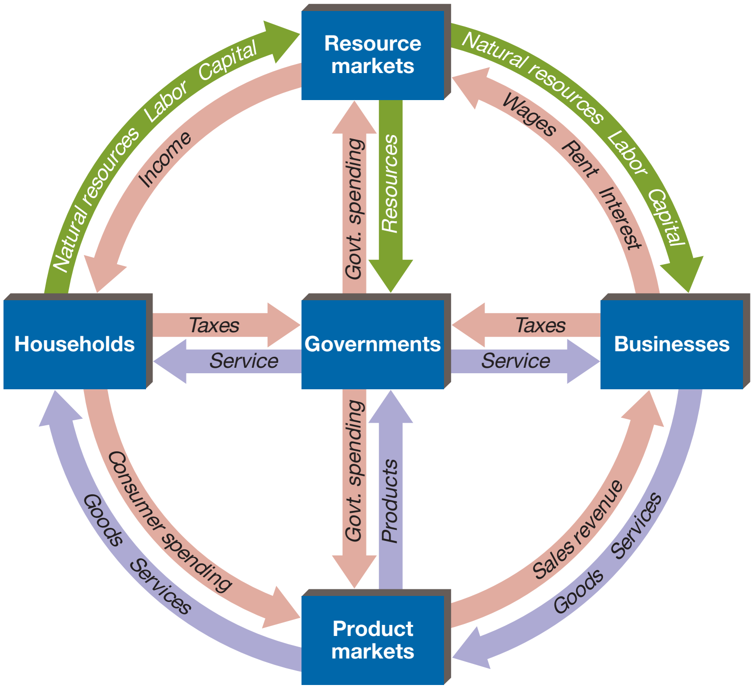
market economy an economic system in which businesses and individuals decide what to produce and buy, and the market determines prices and quantities sold.

mixed economy an economy that exhibits elements of both capitalism and socialism

consumer products goods and services purchased by individuals for personal consumption

Figure 1-5 The Circular Flow in Our Mixed Economy

Our economic system is guided by the interaction of buyers and sellers, with the role of government being taken into account.



Resource markets
Natural resources Labor Capital
Income
Govt. spending
Resources
Natural resources Labor Capital
Wages Rent Interest
Households
Taxes
Service
Governments
Taxes
Service
Businesses
Consumer spending
Goods Services
Govt. spending
Products
Sales revenue
Goods Services
Product markets

individuals for personal consumption.[7] This means that consumers, as a group, are the biggest customers of American business. Consumer spending is a very important component for the financial health of any nation. Consider what happened in the first six months of 2020 in the United States. When the nation experienced the first cases of the COVID-19 virus, consumer spending began to slow down. Then the situation got even worse when non-essential businesses including restaurants, theaters, and some retailers closed down in March and April in many states. When this happened, many consumers were advised (or told) to stay home, and they began to save money and buy only essential items. The combination of fear of losing their job or reduced hours on the job and not knowing how long the pandemic would last caused a huge drop in consumer spending and an economic downturn. Fortunately, consumer spending and the economy began to turn around in the summer of 2020 as businesses began to reopen, and early research indicated that a vaccine that could protect people from the virus and decrease the number of deaths would be available by the end of the year.

Businesses Like households, businesses are engaged in two different exchanges. They exchange money for resources, labor, and capital and use these resources to produce goods and services. Then they exchange their goods and services for sales revenue. This sales revenue, in turn, is exchanged for additional resources, which are used to produce and sell more goods and services.

When business profits are distributed to business owners, these profits become household income. (Business owners are, after all, members of households.) When the economy is running smoothly, households are willing to invest their money in businesses. They can do so directly by buying stocks issued by businesses, by purchasing shares in mutual funds that purchase stocks in businesses, or by lending money to businesses. They can also invest indirectly by placing their money in bank accounts. Banks and other financial institutions then invest money as part of their normal business operations. Thus, business profits, too, are retained in the business system, and the circular flow in Figure 1-5 is complete. How, then, does government fit in?

CAPITALISM
SOCIALISM

M-SUR/SHUTTERSTOCK.COM

Governments The numerous government services are important but they (1) would either not be produced by private business firms or (2) would be produced only for those who could afford them. Typical services include national defense, police, fire protection, education, and construction of roads and highways. To pay for all these services, governments collect a variety of taxes from households (such as personal income taxes and sales taxes) and from businesses (corporate income taxes).

Figure 1-5 shows this exchange of taxes for government services. It also shows government spending of tax dollars for resources and products required to provide these services.

Actually, with government included, our circular flow looks more like a combination of several flows. In reality, it is. The important point is that together the various flows make up a single unit—a complete economic system that provides answers to the basic economic questions. Simply put, the system works.

1-3c Command Economies

A **command economy** is an economic system in which the government decides *what* goods and services will be produced, *how* they will be produced, *for whom* available goods and services will be produced, and *who* owns and controls the major factors of production. Today, two types of economic systems—*socialism* and *communism*—serve as examples of command economies.

Socialism In a socialist economy, the key industries are owned and controlled by the government. Land, buildings, and raw materials may also be the property of the state in a socialist economy. Depending on the country, private ownership of smaller businesses is permitted to varying degrees. Usually, people may choose their own occupations, although many work in state-owned industries. Today, China, New Zealand, Canada, Sweden, and Norway are often referred to as socialist nations because they have adopted *some* socialist policies and welfare programs..

What to produce and how to produce it often are determined in accordance with national goals, which are based on projected needs and the availability of resources. The distribution of goods and services—who gets what—is also controlled by the state to the extent that it controls taxes, rents, and wages. Among the professed aims of socialist countries are the equitable distribution of income, the elimination of poverty, and the distribution of social services (such as medical care) to all who need them. The disadvantages of socialism include increased taxation and loss of incentive and motivation for both individuals and business owners.

Communism If Adam Smith was the father of capitalism, Karl Marx was the father of communism. In his writings during the mid-1800s, Marx advocated a classless society whose citizens together owned all economic resources. All workers would then contribute to this *communist* society according to their ability and would receive benefits according to their need.

Since the breakup of the Soviet Union and economic reforms in China and most of the Eastern European countries, the best remaining example of communism is North Korea. Today, the basic four economic questions (what, how, for whom, and who) are answered through centralized government plans. Emphasis is placed on the production of goods and services the government needs rather than on the needs of consumers, so there are frequent shortages of consumer goods.

✓ Concept Check

- What are the four basic economic questions? How are they answered in a capitalist economy?
- Describe the four basic assumptions required for a laissez-faire capitalist economy.
- Why is the American economy called a mixed economy?
- How does capitalism differ from socialism and communism?

command economy an economic system in which the government decides *what* goods and services will be produced, *how* they will be produced, *for whom* available goods and services will be produced, and *who* owns and controls the major factors of production

1-4 Measuring Economic Performance

Learning Objective

1-4 Identify the ways to measure economic performance.

Consider for just a moment the following questions:

- Are U.S. workers as productive as workers in other countries?
- Is the gross domestic product for the United States increasing or decreasing?
- How does inflation affect the prices that consumers pay for products and services?

Information needed to answer these questions is easily obtainable from many sources. More important, the answers to these and other questions can be used to gauge the economic health of the nation.

1-4a The Importance of Productivity in the Global Marketplace

One way to measure a nation's economic performance is to assess its productivity. While there are other definitions of productivity, for our purposes, **productivity** is the average level of output per worker per hour. An increase in productivity results in economic growth because a larger number of goods and services are produced by a given labor force. To see how productivity affects you and the economy, consider the following three questions:

Question: *How does an increase in productivity affect the economy?*

Answer: Because of increased productivity, it takes fewer workers to produce more goods and services. As a result, employers can reduce costs, earn more profits, and may sell their products or services for less. Finally, productivity growth helps American business to compete more effectively with other nations in a global, competitive world.

Question: *Is an increase in productivity always good?*

Answer: Fewer workers producing more goods and services can lead to lower salary expenses for employers and higher unemployment rates for workers. In this case, increased productivity is good for employers but not good for unemployed workers.

productivity the average level of output per worker per hour

How do you improve productivity? Most experts agree the most important factors needed to improve worker productivity are workers who feel appreciated and valued for the contributions they make to the organization, and being part of an inclusive team. In fact, sharing ideas and different opinions and being part of "the team" are often the foundation for improving a company's productivity.

GAUDILAB/SHUTTERSTOCK.COM

Question: *How does a nation improve productivity?*

Answer: Reducing costs and enabling employees to work more efficiently are at the core of all attempts to improve productivity. Increased productivity is one of the key factors that account for an increase in a nation's gross domestic product.

1-4b The Nation's Gross Domestic Product

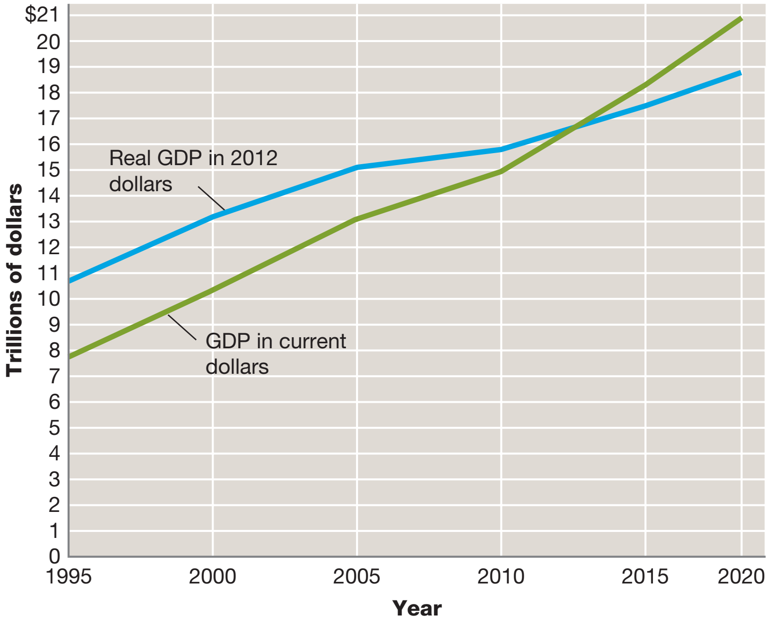
In addition to productivity, a measure called *gross domestic product* can be used to measure the economic well-being of a nation. **Gross domestic product (GDP)** is the total dollar value of all goods and services produced by all people within the boundaries of a country during a specified time period—usually a one-year period. For example, the values of automobiles produced by employees in an American-owned General Motors plant and a Japanese-owned Toyota plant *in the United States* are both included in the GDP for the United States. The U.S. GDP was $20.9 trillion in 2020.[8] (*Note:* At the time of publication, 2020 was the last year for which statistics were available.)

The GDP figure facilitates comparisons between the United States and other countries because it is the standard used in international guidelines for economic accounting. It is also possible to compare the GDP for one nation over several different time periods. This comparison—often called the GDP growth rate—allows observers to determine the extent to which a nation is experiencing economic growth on an annual or quarterly basis. For example, government economic experts project the U.S. GDP will grow approximately 2 percent each year from 2019 to 2029.[9]

To make accurate comparisons of the GDP for different years, we must adjust the dollar amounts for inflation. **Inflation** is a general rise in the level of prices. (The opposite of inflation is deflation.) **Deflation** is a general decrease in the level of prices. By using inflation-adjusted figures, we are able to measure the *real* GDP for a nation. In effect, it is now possible to compare the goods and services produced by a nation in constant dollars—dollars that will purchase the same amount of goods and services. Figure 1-6 depicts the GDP of the United States in current dollars

Figure 1-6 GDP in Current Dollars and in Inflation-Adjusted Dollars

The change in GDP and real GDP for the United States from one year to another year can be used to measure economic growth.



Source: U.S. Bureau of Economic Analysis website at www.bea.gov (accessed January 28, 2021).

gross domestic product (GDP) the total dollar value of all goods and services produced by all people within the boundaries of a country during a specified time period—usually a one-year period

inflation a general rise in the level of prices

deflation a general decrease in the level of prices

Table 1-1 **Common Measures Used to Evaluate a Nation's Economic Health**

Economic Measure	Description
1. Balance of trade	The difference between the value of a nation's exports and a nation's imports over a specific period of time.
2. Consumer confidence index	A measure of how optimistic or pessimistic consumers are about the nation's economy. This measure is usually reported on a monthly basis.
3. Corporate profits	The total amount of profits made by corporations over selected time periods.
4. Inflation rate	An economic statistic that tracks the increase in prices of goods and services over a period of time. This measure is usually reported monthly and calculated on an annual basis.
5. National income	The total income earned by various components of the economy, including employees, interest and rental income, profits from businesses, and other types of income.
6. New housing starts	The total number of new homes started during a specific time period.
7. Prime interest rate	The lowest interest rate that banks charge their most credit-worthy customers.

and the real GDP in inflation-adjusted dollars. Note that between 1995 and 2020, America's real GDP grew from almost $10.7 trillion to $18.8 trillion.[10]

✓ Concept Check

- How does an increase in productivity affect business?
- What is the difference between the gross domestic product and the real gross domestic product? Why are these economic measures significant?
- How does inflation affect the prices you pay for goods and services?
- How is the producer price index related to the consumer price index?

1-4c Other Important Economic Indicators That Measure a Nation's Economy

In addition to productivity, GDP, and real GDP, other economic measures exist that can be used to evaluate a nation's economy. One very important statistic is the unemployment rate. The **unemployment rate** is the percentage of a nation's labor force unemployed at any time. Although the unemployment rate for the United States is typically about 4 to 6 percent, it peaked during the COVID-19 pandemic when the unemployment rate reached almost 15 percent when non-essential businesses were closed in many states. By the end of 2020, the unemployment rate had dropped to just over 6 percent. This is an important statistic—especially if you are unemployed.

The **consumer price index (CPI)** is a monthly index that measures the changes in prices of a fixed basket of goods purchased by a typical consumer in an urban area. Goods listed in the CPI include food and beverages, transportation, housing, clothing, medical care, recreation, education, communication, and other goods and services. Economists often use the CPI to determine the effect of inflation on not only the nation's economy but also individual consumers. Another index is the producer price index. The **producer price index (PPI)** is a monthly index that measures prices that producers receive for their finished goods. Because changes in the PPI reflect price increases or decreases at the wholesale level, the PPI is an accurate predictor of both changes in the CPI and prices that consumers will pay for many everyday necessities in the future.

Some additional economic measures are described in Table 1-1. Like the measures for GDP, real GDP, unemployment rate, and price indexes, these measures can be used to compare one economic statistic over different periods of time.

unemployment rate the percentage of a nation's labor force unemployed at any time

consumer price index (CPI) a monthly index that measures the changes in prices of a fixed basket of goods purchased by a typical consumer in an urban area

producer price index (PPI) a monthly index that measures prices that producers receive for their finished goods

1-5 The Business Cycle

Learning Objective

1-5 Examine the different phases in the typical business cycle.

All industrialized nations of the world seek economic growth, full employment, and price stability. However, a nation's economy fluctuates rather than grows at a steady pace every year. In fact, if you were to graph the economic growth rate for a country like the United States over a long period of time, it would resemble a roller-coaster ride with peaks (high points) and troughs (low points). These fluctuations

Sustaining the Planet

The North Face Believes Sustainability and Social Responsibility Sell

The North Face, an outdoor apparel and gear company founded in 1966, is beginning to see sustainability and social responsibility as factors that can drive profit. Patagonia, its primary competitor, has a long history of sustainability and social responsibility activism while The North Face's efforts have been smaller scale. As sustainability and social responsibility issues have become a greater priority for consumers and investors, The North Face is ramping up its initiatives across all operations, from its supply chain to its finished goods.

The North Face is investing in sustainability and social responsibility to gain more market share in the outdoor apparel market and prepare for a future where customers expect sustainability activism and socially responsible decisions from all companies. For example, a recent decision to create a fund to benefit outdoor workers impacted by the pandemic illustrates The North Face's commitment to sustainability and social responsibility. So far, its sustainability and social responsibility efforts are paying off, as evidenced by an uptick in sales since the company changed its tune.

Considering many consumers, particularly younger consumers, are willing to pay a premium for sustainable products from a socially responsible company, it seems The North Face has made a wise investment. Investors are looking for sustainable-focused firms as well. BlackRock, the world's largest investment asset management company, plans to increase its investments in these types of assets to more than $1 trillion over the next ten years.

Sources: Based on information in Maggie Overfelt, "As The North Face Battles Patagonia in Outdoors Market, It Bets Tackling Climate Change Will Pay Off," *CNBC*, August 14, 2020, www.cnbc.com/2020/08/14/as-north-face-battles-patagonia-it-bets-climate-change-will-pay-off.html; Ed Sealover, "VF Corp's Growth Plan Includes Doubling Down on China, Sustainability in 2021," *Denver Business Journal*, December 30, 2020, www.bizjournals.com/denver/news/2020/12/30/vf-corporation-2021-china-sustainability-denver.html; U.S. Chamber of Commerce, "The North Face Expands Sustainability Efforts to Keep Pace with Market Demands," September 23, 2020, www.uschamber.com/co/good-company/the-leap/the-north-face-renewed-sustainability.

are generally referred to as the **business cycle**, that is, the recurrence of periods of growth and recession in a nation's economic activity.

At the time of publication, the U.S. economy is showing signs of improvement after the effects of a global pandemic. Key economic indicators including the gross domestic product, the stock market, and consumer spending have improved, and the unemployment rate has decreased. And yet, there are concerns about the size of the national debt—a topic described later in this section. There are also concerns about the effect of possible changes by the Biden administration and how those changes could affect individuals, businesses, and the nation's economy. In addition, many experts worry about the economies of foreign nations around the globe and social unrest throughout the world.

The changes that result from either economic growth or an economic downturn affect the demand for products and services that consumers are willing to buy and, as a result, the amount of products and services produced by business firms. Generally, the business cycle consists of four phases: the peak (sometimes called prosperity), recession, the trough, and recovery (sometimes called expansion).

During the *peak period* (prosperity), the economy is at its highest point and unemployment is low. Total income is relatively high. As long as the economic outlook remains prosperous, consumers are willing to buy products and services. In fact, businesses often expand and offer new products and services during the peak period to take advantage of consumers' increased buying power.

Generally, economists define a **recession** as two or more consecutive three-month periods of decline in a country's GDP. Although the recession of 2020 lasted only a few months before the economy began to recover, most recessions are longer. For example, the Great Recession of 2008 lasted 18 months. During a recession, it is typical for the unemployment rate to increase and consumer buying power to

business cycle the recurrence of periods of growth and recession in a nation's economic activity

recession two or more consecutive three-month periods of decline in a country's GDP decline. As buying power declines, consumers tend to purchase essential items and are reluctant to purchase frivolous or non-essential items. In response to a recession, many businesses focus on producing the products and services that provide the most value to their customers. Companies and government at all levels often postpone or go slow on major projects during a recession.

Economists define a **depression** as a severe recession that lasts longer than a typical recession and has a larger decline in business activity when compared to a recession. A depression is characterized by extremely high unemployment rates, low wages, reduced purchasing power, lack of confidence in the economy, a decline in stock values, and a general decrease in business activity. While the United States has experienced many recessions, there have only been a few economic depressions. The worst depression, often called "the Great Depression," began in 1929 lasted over ten years.

The third phase of the business cycle is the *trough*. The trough of a recession or depression is the turning point when a nation's production and employment bottom out and reach their lowest levels. Some experts believe that effective use of monetary and fiscal policies can speed up recovery and reduce the amount of time the economy is in recession. **Monetary policies** are the Federal Reserve's actions to promote maximum employment, stabilize prices, and increase or decrease interest rates. Through **fiscal policy**, the government can influence the amount of savings and expenditures by altering the tax structure and changing the levels of government spending. For example, during the 2020 pandemic crisis both the Federal Reserve's monetary policies (lower interest rates) and the government's fiscal policies (stimulus packages) were used to stabilize the economy.

One of the concerns about the government's recent stimulus programs is the national debt. Although the federal government collects almost $4 trillion in annual revenues, the government usually spends more than it receives, resulting in a **federal deficit**. For example, the government had a federal deficit for each year between 2002 and 2020. The total of all federal deficits is called the **national debt**. Today, the U.S. national debt is over $27 trillion or approximately $83,000 for every man, woman, and child in the United States.[11]

Recovery (or *expansion*) is the movement of the economy from the trough, when a nation's production and employment bottom out and reach their lowest levels, to the next peak in a business cycle. For example, the recession that began in December 2008 lasted 18 months while the recovery that followed the 2008 recession lasted 128 months until February 2020.[12] During the recovery stage of a business cycle, high unemployment rates decline, income increases, and both the ability and the willingness to buy rise for consumers, businesses, and governments.

✓ Concept Check

- What are the four phases in the typical business cycle?
- At the time you are studying the material in this chapter, which phase of the business cycle do you think the U.S. economy is in? Justify your answer.
- How can the Federal Reserve and government use monetary policy and fiscal policy to reduce the effects of an economic crisis?

depression a severe recession that lasts longer than a typical recession and has a larger decline in business activity when compared to a recession

monetary policies Federal Reserve's actions to promote maximum employment, stabilize prices, and increase or decrease interest rates.

fiscal policy government influence on the amount of savings and expenditures; accomplished by altering the tax structure and by changing the levels of government spending

federal deficit a shortfall created when the federal government spends more in a fiscal year than it receives

national debt the total of all federal deficits

competition rivalry among businesses for sales to potential customers

1-6 Types of Competition

Learning Objective

1-6 Outline the four types of competition.

Our capitalist system ensures that individuals and businesses make the decisions about what to produce, how to produce it, and what price to charge for the product. Mattel, Inc., for example, can introduce new versions of its famous Barbie doll, license the Barbie name, change the doll's price and method of distribution, and attempt to produce and market Barbie in other countries or over the internet at www.mattel.com. Our system also allows customers the right to choose between Mattel's products and those produced by competitors.

As a consumer, you get to choose which products or services you want to buy. Competition like that between Mattel and other toy manufacturers is a necessary and extremely important by-product of capitalism. Business **competition** is essentially a rivalry among businesses for sales to potential customers. In a capitalistic economy, competition also ensures that a firm will survive only if it serves its customers well by providing products and services that meet needs. Economists recognize four different degrees of competition ranging from ideal, complete competition to no competition at all. These are perfect competition, monopolistic competition, oligopoly, and monopoly. For a quick overview of the different types of competition, including numbers of firms and examples for each type, look at Table 1-2.

1-6a Perfect Competition

Perfect (or **pure) competition** is the market situation in which there are many buyers and sellers of a product, and no single buyer or seller is powerful enough to affect the price of that product. As pointed out in Table 1-2, real-world examples of perfect competition are corn, wheat, peanuts, and many agricultural products. For perfect competition to exist, there are five very important concepts.

- We are discussing the market for a single product, such as bushels of wheat.
- There are no restrictions on firms entering the industry.
- All sellers offer essentially the same product for sale.
- All buyers and sellers know everything there is to know about the market (including, in our example, the prices that all sellers are asking for their wheat).
- The overall market is not affected by the actions of any one buyer or seller.

When perfect competition exists, every seller should ask the same price that every other seller is asking. Why? Because if one seller wanted 50 cents more for their products than all the others, that seller would not be able to sell a single product. Buyers could—and would—do better by purchasing the same products from the competition. On the other hand, a firm willing to sell below the going price would sell all its products quickly. However, that seller would lose sales revenue (and profit) because buyers are willing to pay more.

In perfect competition, the price of each product is determined by the actions of all buyers and all sellers together through the forces of supply and demand.

The Basics of Supply and Demand The **supply** of a particular product is the quantity of the product that producers are willing to sell at each of various prices. Producers are rational people, so we would expect them to offer more of a product for sale at higher prices and to offer less of the product at lower prices, as illustrated by the supply curve in Figure 1-7.

The **demand** for a particular product is the quantity that buyers are willing to purchase at each of various prices. Buyers, too, are usually rational, so we would expect them—as a group—to buy more of a product when its price is low and to buy less of the product when its price is high, as depicted by the demand curve in Figure 1-7.

The Equilibrium, or Market, Price There is always one certain price at which the demand for a product is equal to the quantity of that product produced. Suppose

Table 1-2 Four Different Types of Competition

The number of firms determines the degree of competition within an industry.

Type of Competition	Number of Business Firms or Suppliers	Real-World Examples
1. Perfect	Many	Corn, wheat, peanuts, many agricultural products
2. Monopolistic	Many	Clothing, shoes
3. Oligopoly	Few	Automobiles, airlines
4. Monopoly	One	Many local public utilities, software protected by copyright

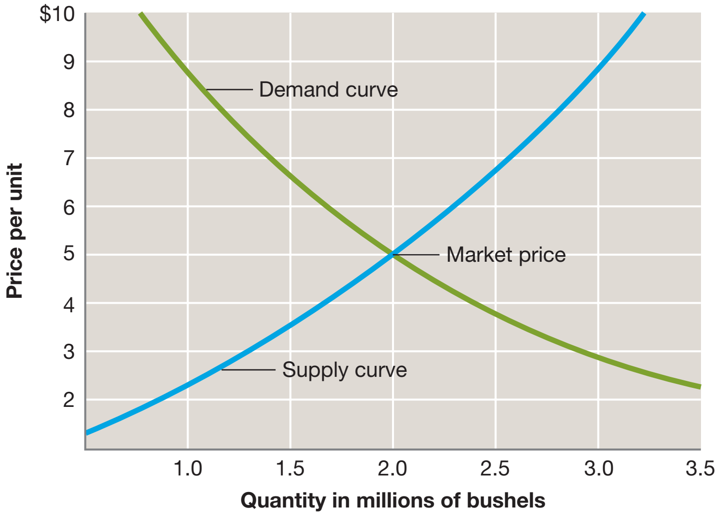
perfect (or **pure) competition** the market situation in which there are many buyers and sellers of a product, and no single buyer or seller is powerful enough to affect the price of that product

supply the quantity of a product that producers are willing to sell at each of various prices

demand the quantity of a product that buyers are willing to purchase at each of various prices

Figure 1-7 Supply Curve and Demand Curve

The interaction of a supply curve and a demand curve is called the equilibrium or market price. This interaction indicates a single price and quantity at which suppliers will sell products and buyers will purchase them.



that producers are willing to *supply* two million bushels of wheat at a price of $5 per bushel and that buyers are willing to *purchase* two million bushels at a price of $5 per bushel. As shown in Figure 1-7, supply and demand are in balance, or in equilibrium, at the price of $5. Economists call this price the *market price*. The **market price** of any product is the price at which the quantity demanded is exactly equal to the quantity supplied.

In theory and in the real world, market prices are affected by anything that affects supply and demand. The *demand* for wheat, for example, might change if researchers suddenly discovered that it offered a previously unknown health benefit. Then buyers would demand more wheat at every price. Or the *supply* of wheat might change if new technology permitted the production of greater quantities of wheat from the same amount of acreage. Other changes that can affect the market price of wheat are shifts in buyer tastes, the development of new products, fluctuations in income owing to inflation or recession, or even changes in the weather that affect the production of wheat.

Perfect competition is quite rare in today's world. Many real markets, however, are examples of monopolistic competition.

1-6b Monopolistic Competition

Monopolistic competition is a market situation in which there are many buyers along with a relatively large number of sellers. Real-world examples of products sold in a monopolistically competitive market include clothing, shoes, soaps, furniture, and many consumer items. The various products available in this type of competitive market are similar in nature, and they are all intended to satisfy the same basic need. However, each seller attempts to make its product different from the others by providing unique product features, an attention-getting brand name, unique packaging, or services such as free delivery or a lifetime warranty.

Product differentiation is the process of developing and promoting differences between a company's products and all competitive products. It is a fact of life for the producers of many consumer goods, from soaps to clothing to furniture to shoes. A furniture manufacturer such as Bush Industries sees what looks like a mob of competitors, all trying to chip away at its share of the ready-to-assemble furniture

market price the price at which the quantity demanded is exactly equal to the quantity supplied

monopolistic competition a market situation in which there are many buyers along with a relatively large number of sellers who differentiate their products from the products of competitors

product differentiation the process of developing and promoting differences between a company's products and all competitive products

macy's
TOMMY HILFIGER

QUALITYHD/SHUTTERSTOCK.COM

How does competition affect a retailer like Macy's? For Macy's, competition is a way of life. Executives know they must compete with Dillard's, Target, Walmart, Amazon, and other retailers—all businesses that sell clothing and many other products. Each retailer uses product differentiation to differentiate its merchandise from competitors on the basis of price, quality, brand names, customer service, and other factors that can entice a customer to shop at one store instead of a competitor.

market. By differentiating each of its products from all similar products produced by competitors, Bush Industries obtains some limited control over the market price of its product.

1-6c **Oligopoly**

An **oligopoly** is a market (or industry) situation in which there are few sellers. Generally, these sellers are quite large, and sizable investments are required to enter into their market. Examples of oligopolies are the automobile, airline, car rental, cereal, and farm implement industries.

Because there are few sellers in an oligopoly, the market actions of each seller can have a strong effect on competitors' sales and prices. For instance, when General Motors began offering cash incentives to encourage consumers to purchase new Chevrolet and GMC trucks at the beginning of 2021, Ford, Nissan, and Toyota began offering similar incentives and for the same reasons—to attract new-car buyers and to retain their market share. In the absence of much price competition, product differentiation becomes the major competitive weapon; this is very evident in the advertising of the major automobile manufacturers.

1-6d **Monopoly**

A **monopoly** is a market (or industry) with only one seller, and customers can only buy the product or service from that seller. In a monopoly, there is no close substitute for the product or service. Because only one business is the seller of a product or service, it would seem that it has complete control over price. However, no business can set its price at some astronomical amount just because there is no competition; the business would soon find that it has no customers or sales revenue either. Instead, the business in a monopoly position must consider the demand for its product and set the price at the most profitable level.

oligopoly a market (or industry) in which there are few sellers

monopoly a market (or industry) with only one seller, and customers can only buy the product or service from that seller

Classic examples of monopolies in the United States are public utilities, including companies that provide local gas, water, sewer services, or electricity. Each utility firm operates in a *natural monopoly*, an industry that requires huge start-up costs that act as a deterrent for potential competitors. Natural monopolies are permitted to exist, but they operate under the scrutiny and control of various state and federal agencies. Although many public utilities are still classified as natural monopolies, there is increased competition in many areas of the country. For example, consumers now have a choice when selecting a company that provides electrical service to both homes and businesses in many areas of the country.

A legal monopoly—sometimes referred to as a *limited monopoly* or *statutory monopoly*—is created when a government entity issues a license, franchise, copyright, patent, or trademark. Because Microsoft owns the trademarks on its popular logos, it can control how both trademarks and logos are used by other businesses or individuals. Except for natural monopolies and legal monopolies, federal antitrust laws discourage or prohibit both monopolies and attempts to form monopolies in order to ensure that competitive markets exist and customers have a choice for products or services they need or want to purchase.

✓ Concept Check

- Is competition good for business? Is it good for consumers?
- Explain how the equilibrium or market price of a product is determined.
- Compare the four forms of competition.

1-7 American Business Today

Learning Objective

1-7 Summarize the development of American business and the challenges that businesses and society will encounter in the future.

Although our economic system is far from perfect, it provides Americans with a high standard of living compared with people in other countries throughout the world. **Standard of living** is a loose, subjective measure of how well off an individual or a society is, mainly in terms of want satisfaction through goods and services. Also, our economic system offers solutions to many of the problems that plague society and provides opportunities for people who are willing to work and to continue learning.

To understand the current business environment and the challenges ahead, it helps understand how business developed.

1-7a Early Business Development

Our American business system has its roots in the knowledge, skills, and values that the earliest settlers brought to this country. The first settlers in the United States were concerned mainly with providing themselves with basic necessities—food, clothing, and shelter. Almost all families lived on farms, and the entire family worked at the business of surviving. They used their surplus of agricultural products for trading, mainly by barter, among themselves and with the English trading ships that called at the colonies. As this trade increased, small businesses began to appear. Some settlers were able to use their skills and their excess time to work under the domestic system of production. The **domestic system** was a method of manufacturing in which an entrepreneur distributed raw materials to various homes, where families would process them into finished goods. The entrepreneur then offered the goods for sale.

Then, in 1793, a young English apprentice mechanic named Samuel Slater opened a textile mill in Pawtucket, Rhode Island, to spin raw cotton into thread. Slater's textile mill was America's first use of the **factory system** of manufacturing, in which all the materials, machinery, and workers required to manufacture a product are assembled in one place. The Industrial Revolution in America was born.

A manufacturing technique called *specialization* was used to improve productivity. **Specialization** is the separation of a manufacturing process into distinct tasks and the assignment of different tasks to different individuals.

Entrepreneurs continued to invent new machinery during the 1800s. Often, historians call this time period the golden age of invention and innovation. At the same time, new means of transportation greatly expanded the domestic markets for American products. Certainly, many basic characteristics of our modern business system took form during this time period.

standard of living a loose, subjective measure of how well off an individual or a society is, mainly in terms of want satisfaction through goods and services

domestic system a method of manufacturing in which an entrepreneur distributed raw materials to various homes, where families would process them into finished goods to be offered for sale by the entrepreneur

factory system a system of manufacturing in which all the materials, machinery, and workers required to manufacture a product are assembled in one place

specialization the separation of a manufacturing process into distinct tasks and the assignment of different tasks to different individuals

1-7b **Business Development in the 1900s**

Industrial growth and prosperity continued well into the 20th century. Henry Ford's moving automotive assembly line, which brought the work to the worker, refined the concept of specialization and helped spur on the mass production of consumer goods. Fundamental changes occurred in business ownership and management as well. No longer were the largest businesses owned by one individual; instead, more companies were owned by stockholders who were willing to invest in—but not to operate—a business.

To understand the major events that shaped the United States during the 20th century, it helps to remember that the economy was compared to a roller-coaster ride earlier in this chapter—periods of economic growth followed by periods of economic slowdown. The following are major events that shaped the nation's economy during the period from 1910 to 2000:

- The 1929 stock market crash and the Great Depression
- Federal government involvement in business in order to stimulate the economy, reduce unemployment, and ease the problems during the Great Depression
- World War I, World War II, the Korean War, and the Vietnam War
- Rapid economic growth and higher standard of living during the 1950s and 1960s
- The social responsibility movement during the 1960s
- A shortage of crude oil and higher prices for most goods in the mid-1970s
- High inflation, high interest rates, and reduced business profits during the last part of the 1970s and early 1980s
- Sustained economic growth in the 1990s

Unfortunately, by the last part of the 1990s, an increasing number of business failures, higher interest rates, and concerns about the financial markets and the economy were signs that larger economic problems were on the way.

FORD MOTOR COMPANY.

BERNI0004/SHUTTERSTOCK.COM

Think for a moment what Henry Ford would think about today's automated factories. It's fair to assume he would be amazed at how manufacturing has developed in just over 100 years. While today's factories are definitely more advanced, don't underestimate the significance of Ford's assembly line back in 1913. Simply put, it not only changed the way automobiles like the one in this photo were manufactured, but it also led to changes in the way just about everything else was manufactured.

1-7c A New Century: 2000 and Beyond

According to many economic experts, the first part of the 21st century might be characterized as the best of times and the worst of times rolled into one package. On the plus side, technology became available at an affordable price. Both individuals and businesses could now access information with the click of a button. They also could buy and sell merchandise online as e-commerce became a new type of retailing.

In addition to information technology, the growth of service businesses also changed the way American firms do business in the 21st century. Because service businesses employ over 80 percent of the nation's workforce, we now have a service economy.[13] A **service economy** is an economy in which more effort is devoted to the production of services than to the production of goods. Typical service businesses include restaurants, dry cleaners, real estate, movie theaters, repair companies, and other services. More information on services is provided in Chapter 8, Producing Quality Goods and Services.

On the negative side, it is hard to watch television, surf the Web, listen to the radio, or read the newspaper without hearing news about the economy, social and political unrest in the world, and lingering health and economic problems caused by the COVID-19 pandemic. Because many economic indicators suggest that either current or future problems could affect the nation's economy, there is still a certain amount of pessimism surrounding the nation's economy and the global economy. In addition, there are other concerns including social unrest; political uncertainty on the national, state, and local levels; global terrorism; and the threat of wars around the globe.

1-7d The Current Business Environment

Before reading on, answer the following question:

In today's competitive business world, which of the following environments affects business?

a. The competitive environment
b. The global environment
c. The technological environment
d. The economic environment
e. All of the above

Correct Answer: e. All the environments listed in the above question affect business today.

The Competitive Environment As noted earlier in this chapter, competition is a basic component of capitalism. Every day, business owners must figure out what makes their businesses successful and how the goods and services they provide are different from the competition. Often, the answer is contained in the basic definition of business provided on page 9. Just for a moment, review the definition:

> *Business is the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs.*

In the definition of business, note the phrase *satisfy society's needs*. These three words say a lot about how well a successful firm competes with competitors. If you meet customer needs, then you have a better chance at success.

service economy an economy in which more effort is devoted to the production of services than to the production of goods

The Global Environment Related to the competitive environment is the global environment. Not only do American businesses have to compete with other American businesses, but they also must compete with businesses from all over the globe.

RAWPIXEL.COM/SHUTTERSTOCK.COM

Technology, technology, and more technology! What would happen if you didn't have your cell phone or if you couldn't use a computer for the next 24 hours? For many people, it would be catastrophic. For businesses, it would be just as bad. Many businesses rely on technology to operate. Without technology to process customer payments, track inventory, maintain accounting records, and other critical business activities, it would be impossible to function. For many businesses, it could mean they might have to "close the doors" until their technology was restored.

Firms in other countries including China, Japan, India, Germany, Vietnam, and most of the remaining European and Asian countries around the world also compete with U.S. firms. There was once a time when the label "Made in the United States" gave U.S. businesses an inside edge both at home and in the global marketplace. Today, because business firms in other countries manufacture and sell goods, the global marketplace has never been more competitive.

While many foreign firms are attempting to sell goods and services to U.S. customers, U.S. firms are also increasing both sales and profits by selling goods and services to customers in other countries. In fact, there are many "potential" customers in developing nations that will buy goods and services manufactured by U.S. firms. For example, Procter & Gamble sells laundry detergent, soap, health and grooming products, and baby products in Asia, Europe, India, the Middle East, Africa, Latin America, and North America. And Procter & Gamble is not alone. Unilever, DuPont, Johnson & Johnson, General Motors, and many more U.S. companies are also selling goods and services to customers in countries all over the globe.

The Technological Environment The technological environment for U.S. businesses has never been more challenging. Changes in communication with customers, manufacturing equipment, and distribution of products are all examples of how technology has changed everyday business practices. For example, many businesses are now using social media to provide customers with information about products and services. For our purposes **social media** is defined as online interaction that allows people and businesses to communicate and share ideas, personal information, and information about products or services. Because of rapid developments in social media and the increased importance of technology and information, businesses will need to spend additional money to keep abreast of an ever-changing technological environment and even more money to train employees to use the new technology.

New and creative ways to use technology are also changing the way that products are now manufactured and distributed to customers. Today, many manufacturers are using sophisticated automated equipment to improve employee productivity,

social media the online interaction that allows people and businesses to communicate and share ideas, personal information, and information about products or services

Technology and Innovation

Today's Biggest Tech Trends

The technological environment is ever-changing, and it's critical for businesses to keep pace or risk being left behind. The biggest trends in today's tech world include artificial intelligence, blockchain technology, and extended reality.

Artificial intelligence (AI) involves computers performing tasks that traditionally require human intelligence. Since programming an AI-based system is cost-prohibitive for most organizations, many professionals will interact with the technology through available platforms, such as e-mail marketing software. Additionally, automation in manufacturing and supply chains is greatly improving with the use of AI and robotics. With the number of AI providers growing, adoption of the technology will continue to increase for years to come.

Blockchain, a secure digital ledger, has many applications, from supply chain management to cryptocurrency. The hype around blockchain has been around for years, but now there is an emerging shared belief that blockchain technology will become a top strategic priority for many businesses and organizations. Popular uses for the technology include recording transactions, data validation, data access, data sharing, and identity protection.

Extended reality (XR) encompasses technologies that create an immersive or all-in experience, namely virtual reality (VR) and augmented reality (AR). Many consumers have interacted with VR and AR in the form of video games and smartphone features such as VR headsets or social media apps, but XR has even more unlocked potential. Businesses that get a better handle on XR will discover new methods of customer engagement.

AI, blockchain, and XR are just a few of the technologies shaking up the world of business. Keeping up with key trends and investing in new technologies that add value to the business will help organizations stay ahead of the curve. Knowledge and experience about emerging technologies will also help workers and job seekers advance their careers.

Sources: Based on information in Deloitte, "C-Suite Briefing: 5 Blockchain Trends for 2020," March 2020, www2.deloitte.com/content/dam/Deloitte/ie/Documents/Consulting/Blockchain-Trends-2020-report.pdf; Bernard Marr, "The 7 Biggest Technology Trends in 2020 Everyone Must Get Ready for Now," *Forbes*, September 30, 2019, www.forbes.com/sites/bernardmarr/2019/09/30/the-7-biggest-technology-trends-in-2020-everyone-must-get-ready-for-now/; Anis Uzzaman, "Top Business and Technology Trends in 2021," *Inc.*, December 15, 2020, www.inc.com/anis-uzzaman/top-business-technology-trends-in-2021.html.

increase product quality, and lower expenses. Technology has also changed the way customers purchase products and the way those products are delivered. For example, if you purchase merchandise on Amazon's e-commerce website, you don't necessarily wait days to receive your merchandise. Depending on your location and if the merchandise is available, your purchase could be delivered the same day. While this type of technology-driven delivery system is expensive, it is one reason why Amazon has grown to be one of the largest retailers in the world.

The Economic Environment The economic environment must always be considered when making business decisions. This fact is especially important when the nation's economy takes a nosedive or an individual firm's sales revenues and profits are declining. Consider what happened when non-essential businesses were ordered to close in many states because of the COVID-19 pandemic. Both small and large non-essential businesses had no sales revenues and had to use cash reserves to pay expenses. In many cases employees were placed on leave or lost their jobs. As businesses began to reopen, customers began to buy products and services, and businesses brought back furloughed employees or hired new employees.

In addition to economic pressures, today's socially responsible managers and business owners must be concerned about the concept of sustainability. According to the U.S. Environmental Protection Agency, **sustainability** is the ability to create and maintain conditions under which present and future generations can

sustainability the ability to create and maintain conditions under which present and future generations can exist in productive harmony, and permit fulfilling the social, economic, and other requirements of future and present generations exist in productive harmony, and permit fulfilling the social, economic, and other requirements of future and present generations.[14] Although the word *green* used to mean a color in a box of crayons, today green means a new way of doing business. As a result, a combination of forces, including economic factors, growth in population, increased energy use, and concerns for the environment, is changing the way individuals live and businesses operate.

When you look back at the original question we asked at the beginning of this section, clearly, each different type of environment—competitive, global, technological, and economic—affects the way a business does *business*. As a result, there are always opportunities for improvement and challenges that must be considered.

1-7e **The Challenges Ahead**

There it is—the American business system in brief.

When it works well, it provides a standard of living that few countries can match and many opportunities for personal advancement for those willing to work hard and continue to learn. However, like every other system devised by humans, it is not perfect. Our capitalist economic system may give us prosperity, but it also gave us the Great Depression of the 1930s, the economic problems of the 1970s and the early 1980s, and a volatile stock market, high unemployment, and business failures caused by the COVID-19 pandemic.

Obviously, the system can be improved. Certainly, there are plenty of people who are willing to tell us exactly what they think the American economy needs. However, these people often provide us only with conflicting opinions. Who is right and who is wrong? Even the experts cannot agree.

The experts do agree, however, that several key issues will challenge our economic system (and our nation) over the next decade. Some of the questions to be resolved include:

- How can we deal with social unrest, discrimination, and inequality in society?
- How can we create a more stable economy and create new, quality jobs for the unemployed?
- How can we reduce the number of low-income workers and increase the number of middle- and higher-income workers?
- How can we use research and technology to make American workers more productive and American firms more competitive in the global marketplace?
- How can we preserve the benefits of competition and small business in our American economic system?
- How do we reduce the national debt and stimulate business growth?
- How can we conserve natural resources and sustain our environment?
- How can we meet the needs of low-income families, single parents, older Americans, and the less fortunate who need healthcare and social programs to exist?

The answers to these questions are anything but simple. While there have been (and always will be) challenges for a nation like the United States, Americans have always been able to solve many of their problems through ingenuity and creativity. Now, as we continue the journey through the 21st century, we need that same ingenuity and creativity not only to solve our current problems but also to compete in the global marketplace and build a nation and economy for future generations.

The American business system is not perfect by any means, but it does work reasonably well. We discuss some of its problems in Chapter 2 as we examine the topics of social responsibility and business ethics.

✓ **Concept Check**

- How does your standard of living affect the products or services you buy?
- What is the difference between the domestic system and the factory system?
- Choose one of the environments that affect business or society and explain how it affects a small electronics manufacturer located in Portland, Oregon.
- What do you consider the most important challenge that will face people in the United States in the years ahead?

Summary

1-1 Discuss what you must do to be successful in today's business world.

When faced with the COVID-19 pandemic that raced through the world, small business owners, employees, managers, investors, and a large number of people began to ask the question: What effect will non-essential business closures and record high unemployment rates have on the economy? More specifically, many people asked, how does this affect me both now and in the future? Although this is a fair question, it is difficult to answer. Certainly, for a college student taking business courses or an employee just starting a career, the question is even more difficult to answer. And yet there are still opportunities out there for people who are willing to work hard, continue to learn, and possess the ability to adapt to change. By studying business, you can become a better employee or manager or you may decide to start your own business. You can also become a better consumer and investor.

1-2 Identify the potential risks and rewards of business.

Business is the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs. Four kinds of resources— material, human, financial, and informational—must be combined to start and operate a business. The three general types of businesses are service businesses, manufacturers, and marketing intermediaries. Today, marketing intermediaries sell goods and services in brick-and-mortar stores, online, or both. Profit is what remains after all business expenses are deducted from sales revenue. It is the payment that owners receive for assuming the risks of business—primarily the risks of not receiving payment and of losing whatever has been invested in the firm. Although many people believe that profit is literally the bottom line or most important goal for a business, the ultimate objective of a successful business is to satisfy the needs of its customers. In addition to profit, many corporations are careful to point out their efforts to sustain the planet, participate in the green ecological movement, and help people to live better lives.

1-3 Describe the two types of economic systems: capitalism and command economy.

Economics is the study of how wealth is created and distributed. An economic system must answer four questions: *What* goods and services will be produced? *How* will they be produced? *For whom* will they be produced? And *Who* owns and who controls the major factors of production? The factors of production are land and natural resources, labor, capital, and entrepreneurship. Capitalism (on which our economic system is based) is an economic system in which individuals own and operate the majority of businesses that provide goods and services. Capitalism stems from the theories of Adam Smith. Smith's pure laissez-faire capitalism is an economic system based on the assumptions described in Figure 1-4.

Our economic system today is a mixed economy and exhibits elements of both capitalism and socialism. In the circular flow that characterizes our business system (refer to Figure 1-5), households and businesses exchange resources, labor, and capital for goods and services, using money as the medium of exchange. In a similar manner, the government collects taxes from businesses and households and purchases products and resources with which to provide services.

In a command economy, government, rather than individuals, owns many of the factors of production and provides the answers to the three other economic questions. Socialist and communist economies are—at least in theory—command economies.

1-4 Identify the ways to measure economic performance.

One way to evaluate the performance of an economic system is to assess changes in productivity, which is the average level of output per worker per hour. Gross domestic product (GDP) can also be used to measure a nation's economic health and is the total dollar value of all goods and services produced by all people within the boundaries of a country during a one-year period. It is also possible to adjust GDP for inflation and thus to measure real GDP. Other economic indicators include a nation's balance of trade, consumer confidence index, consumer price index (CPI), corporate profits, inflation rate, national income, new housing starts, prime interest rate, producer price index (PPI), and unemployment rate.

1-5 Examine the different phases in the typical business cycle.

A nation's economy fluctuates rather than grows at a steady pace every year. These fluctuations are generally referred to as the business cycle. Generally, the business cycle consists of four states: the peak (sometimes called prosperity), recession, the trough, and recovery (sometimes called expansion). Some experts believe that effective use of monetary policy (the Federal Reserve's decisions to promote maximum employment, stabilize prices, and increase or decrease interest rates) and fiscal policy (the government's influence on the amount of savings and expenditures) can speed up recovery.

A federal deficit occurs when the government spends more than it receives in taxes and other revenues. At the time of publication, the national debt is over $27 trillion or approximately $83,000 for every man, woman, and child in the United States.

1-6 Outline the four types of competition.

Competition is essentially a rivalry among businesses for sales to potential customers. In a capitalist economy, competition works to ensure the efficient and effective operation of business. Competition also ensures that a firm will survive only if it serves its customers well by providing goods and services that meet their needs. Economists recognize four degrees of competition. Ranging from most to least competitive, the four degrees are perfect competition, monopolistic competition, oligopoly, and monopoly. The factors of supply and demand generally influence the price that customers pay producers for goods and services.

1-7 Summarize the development of American business and the challenges that businesses and society will encounter in the future.

To understand the major events that shaped the United States, it helps to remember that the economy was compared to a roller-coaster ride earlier in this chapter—periods of economic growth followed by periods of economic slowdown. Events and a changing business environment including the Great Depression, government involvement in business, wars, rapid economic growth, the social responsibility movement, a shortage of crude oil, high inflation, high interest rates, reduced business profits, increased use of technology, and social media all have shaped business and the economy.

Now more than ever before, the way a business operates is affected by the competitive environment, global environment, technological environment, and economic environment. As a result, business has a number of opportunities for improvement and challenges for the future.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

free enterprise (4)
cultural (or workplace) diversity (6)
business (9)
e-business (10)
profit (11)
stakeholders (11)
economics (12)
microeconomics (12)
macroeconomics (13)
economy (13)
factors of production (13)
entrepreneur (13)
capitalism (14)
invisible hand (14)
market economy (15)
mixed economy (15)
consumer products (15)
command economy (17)
productivity (18)
gross domestic product (GDP) (19)
inflation (19)
deflation (19)
unemployment rate (20)
consumer price index (CPI) (20)
producer price index (PPI) (20)
business cycle (21)
recession (21)
depression (22)
monetary policies (22)
fiscal policy (22)
federal deficit (22)
national debt (22)
competition (22)
perfect (or pure) competition (23)
supply (23)
demand (23)
market price (24)
monopolistic competition (24)
product differentiation (24)
oligopoly (25)
monopoly (25)
standard of living (26)
domestic system (26)
factory system (26)
specialization (26)
service economy (28)
social media (29)
sustainability (30)

Discussion Questions

1. What factors caused American business to develop into a mixed economic system rather than some other type of economic system?
2. Does an individual consumer really have a voice in answering the four basic economic questions described on page 14?
3. Is gross domestic product a reliable indicator of a nation's economic health? What might be a better indicator?
4. Discuss this statement: "Business competition encourages improved product quality and increased customer satisfaction."
5. Is government participation in our business system good or bad? What factors can be used to explain your position.
6. Choose one of the challenges listed on page 31 and describe possible ways in which business and society could help to solve or eliminate the problem in the future.

Case 1

The Keys to Zoom's Success

Zoom—a video conference technology company based in San Jose, California—not only broke into a highly competitive industry, but it also became an industry leader. Zoom's success can be attributed to good leadership, a growing market, a customer orientation, accessibility, and the ability to secure funding.

Eric Yuan is the CEO and founder of Zoom. He got the idea for the company when he was in college in the 1980s and regularly took a 10-hour train ride to visit his then-girlfriend. He knew there had to be an easier way to see her. At the time, video communication was a distant dream as widespread consumer internet use was still years away. After relocating from China to the United States in 1997, Yuan landed a software developer job at Webex, an online communications company, in the midst of the so-called dot-com boom. The dot-com era was marked by a period of rapid growth in internet use. While excessive investor speculation of internet firms caused a stock market bubble that would eventually burst, Webex remained strong. When Cisco acquired Webex in 2007 for $3.2 billion, Yuan became the vice president of engineering, overseeing more than 800 employees. Yuan, however, wasn't happy with the company's online service, which often cut in and out and lacked various modern features. His calls to update the platform were ignored, so he left in 2011 to build a cloud-based video-conferencing tool of the future that prioritized customers and their needs.

Zoom, founded in 2011, entered the video communications market at a time when consumer and business demand for video conference products was increasing. It was around the same time that Apple introduced FaceTime and Skype was acquired by Microsoft for $8.5 billion. Almost a decade later when the COVID-19 pandemic struck, the demand for Zoom's products accelerated as the need to communicate from a distance became more prevalent than ever.

Yuan decided that his company's vision would be "video is the new voice" and its goal would be to deliver happiness. It's this customer orientation that has contributed to Zoom's success. From Yuan's experience at his previous company, he knew consistent and quality video connections should be a priority. To add to that, Zoom offers 24/7 customer service, which Yuan would often take part in during Zoom's early years. Yuan would reach out to any individual who canceled their service. This focus on customer service is a large reason behind Zoom's high customer satisfaction ratings.

Another key element in Zoom's success is accessibility. When it launched, Zoom had several competitive advantages. For instance, its software identified the user's device, eliminating the need for multiple versions of the software. Additionally, it had high security protections in place that kept bugs out. But perhaps most important to the customer, Zoom was able to operate on slow internet connections. From the start, Zoom was easy to use, and this holds true today. Case in point, when someone is invited to a Zoom meeting, they need only to click a link to attend. Even if users choose to register for a basic account, it's free to host up to 100 participants with an unlimited number of meetings. Premium features are available on Pro, Business, and Enterprise accounts at competitive rates. This is known as a "freemium" pricing model. By offering free entry-level access, Zoom has opened up its platform to the masses and lowered barriers to product trial.

Many start-ups struggle to find financing. Initial funding for Zoom came from Webex executives who knew Yuan and believed in his ability to build a quality product. Though Zoom didn't see profits for many years, investors kept investing because of the platform's promising future. When Zoom made its initial public offering (IPO) on the Nasdaq stock market, it was already growing and profitable, a rarity for tech companies. With an IPO price of $36 per share, Zoom was valued at $9.2 billion. Now, the video communications company is valued at close to $100 billion.

Yuan's ability to identify a growing market and create a superior product that was easy to use led to Zoom's present-day success. The COVID-19 pandemic only accelerated Zoom's path to the front of the pack. As people worked from home, students attended school online, and friends gathered for virtual happy hours, Zoom emerged as the go-to service. Looking to the future, Zoom is focusing on new products and winning over large clients. Maintaining its customer orientation and continuing to innovate will better prepare Zoom for future growth opportunities and challenges.[15]

Questions

1. What entrepreneurial traits did Eric Yuan—the founder of Zoom—have that enabled him to turn an idea into a very successful company in a very competitive market?
2. One of the benchmarks of a successful business is satisfying the needs of its customers. How is Zoom meeting the needs of its customers?
3. One reason Zoom has been successful is that it is easy to use. What other factors have made Zoom a popular choice for video conferencing?

Building Skills for Career Success

1. Social Media Exercise

Today, many companies use Facebook, Twitter, Instagram, and other social media sites in addition to their corporate website. Think of three of your favorite car companies and conduct a quick search using a search engine like Google or Yahoo! Then answer the following:

1. Name the social networks for each company.
2. Compare each of their Facebook pages. How many "likes" does each company have? Are there multiple pages for the company? How much interaction (or engagement) is on each Facebook page?
3. What business goals do you think each company is trying to reach through their Facebook presence?

2. Building Team Skills

Over the past few years, employees have been expected to function as productive team members instead of working alone. People often believe that they can work effectively in teams, but many people find working with a group to be a challenge.

College classes that function as teams are more interesting and more fun to attend, and students generally learn more about the topics in the course. One way to begin creating a team is to learn something about each student in the class. This helps team members to feel comfortable with each other and fosters a sense of trust.

Assignment

1. Find a partner, preferably someone you do not know.
2. Each partner has two to three minutes to answer the following questions:
   a. What is your name, and where do you work?
   b. What interesting or unusual thing have you done in your life? (Do not talk about work or college; rather, focus on such things as hobbies, travel, family, and sports.)
   c. Why are you taking this course, and what do you expect to learn? (Satisfying a degree requirement is not an acceptable answer.)
3. Introduce your partner to the class. Use one to two minutes, depending on the size of the class.

3. Researching Different Careers

In this chapter, *entrepreneurship* is defined as the willingness to take risks and the knowledge and ability to use the other factors of production efficiently. An *entrepreneur* is a person who risks time, effort, and money to start and operate a business. Some people believe that these terms apply only to small businesses. However, employees with entrepreneurial attitudes are often viewed as more valuable and can advance more rapidly in large companies.

Assignment

1. Use the internet or go to the local library and research how large firms, especially large corporations, are rewarding employees who have entrepreneurial skills.
2. Find answers to the following questions:
   a. Why is an entrepreneurial attitude important in large corporations today?
   b. What makes an entrepreneurial employee different from other employees?
   c. How are these employees being rewarded, and are the rewards worth the effort?
3. Write a two-page report that summarizes your findings.

Chapter

2

METAMORWORKS/SHUTTERSTOCK.COM

Ethics and Social Responsibility in Business

Why Should You Care?

Business ethics and social responsibility issues have become extremely relevant in today's business world. Business schools teach business ethics to prepare managers to be more responsible. Corporations are developing ethics and social responsibility programs to help meet these needs in the workplace.

Learning Objectives

Once you complete this chapter, you will be able to:

2-1 Define *business ethics.*

2-2 Identify the types of ethical concerns that arise in the business world.

2-3 Discuss the factors that affect the level of ethical behavior in organizations.

2-4 Explain how organizations can encourage ethical decision making in business.

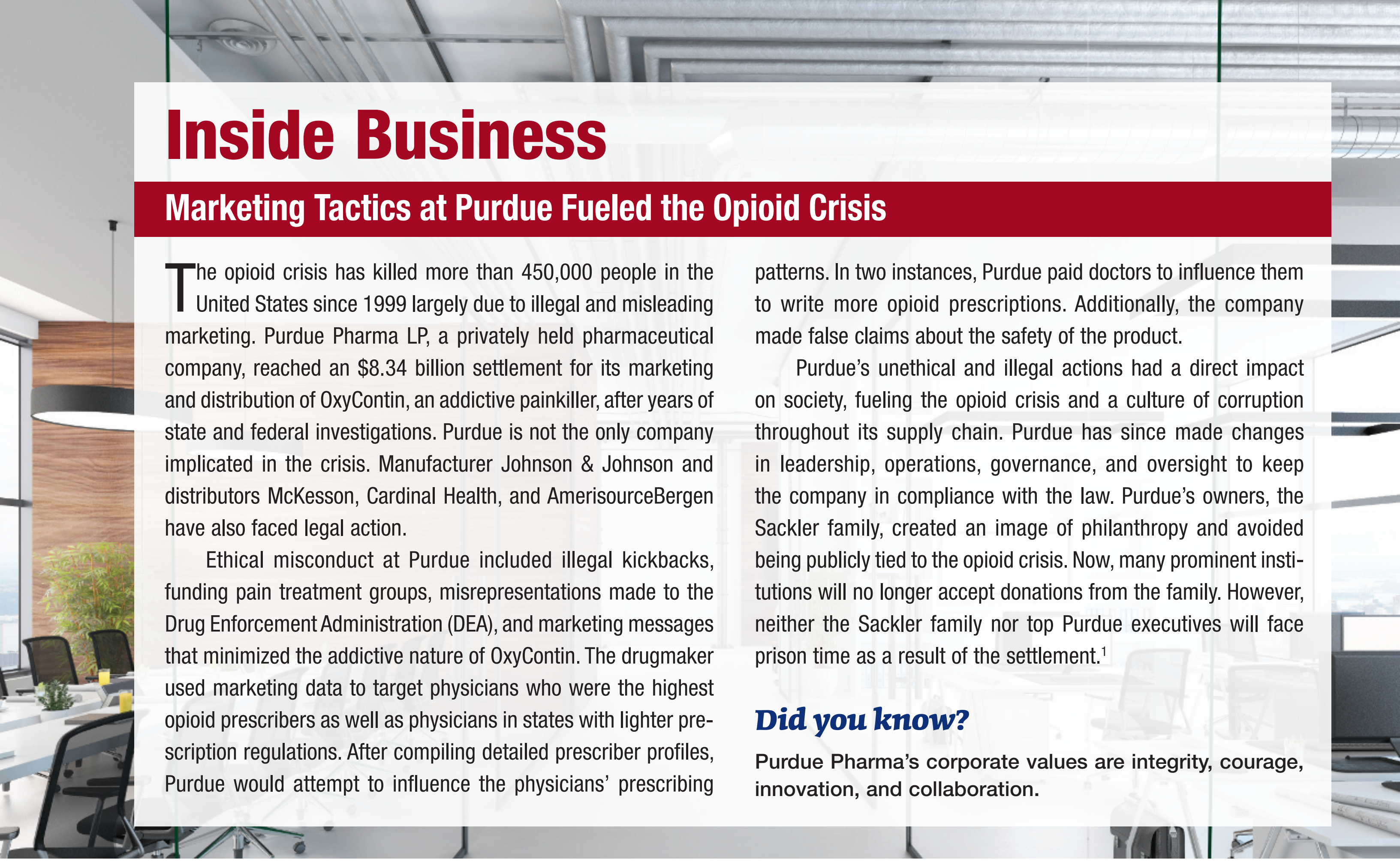
2-5 Describe how our current views on the social responsibility of business have evolved.

2-6 List the responsibilities businesses have to the public, especially with regard to consumer rights and public health.

2-7 Analyze how present employment practices are being used to counteract past abuses.

2-8 Describe the major environmental issues and businesses' response to them.

2-9 Identify the steps a business must take to implement a program of social responsibility.



Inside Business

Marketing Tactics at Purdue Fueled the Opioid Crisis

The opioid crisis has killed more than 450,000 people in the United States since 1999 largely due to illegal and misleading marketing. Purdue Pharma LP, a privately held pharmaceutical company, reached an $8.34 billion settlement for its marketing and distribution of OxyContin, an addictive painkiller, after years of state and federal investigations. Purdue is not the only company implicated in the crisis. Manufacturer Johnson & Johnson and distributors McKesson, Cardinal Health, and AmerisourceBergen have also faced legal action.

Ethical misconduct at Purdue included illegal kickbacks, funding pain treatment groups, misrepresentations made to the Drug Enforcement Administration (DEA), and marketing messages that minimized the addictive nature of OxyContin. The drugmaker used marketing data to target physicians who were the highest opioid prescribers as well as physicians in states with lighter prescription regulations. After compiling detailed prescriber profiles, Purdue would attempt to influence the physicians' prescribing patterns. In two instances, Purdue paid doctors to influence them to write more opioid prescriptions. Additionally, the company made false claims about the safety of the product.

Purdue's unethical and illegal actions had a direct impact on society, fueling the opioid crisis and a culture of corruption throughout its supply chain. Purdue has since made changes in leadership, operations, governance, and oversight to keep the company in compliance with the law. Purdue's owners, the Sackler family, created an image of philanthropy and avoided being publicly tied to the opioid crisis. Now, many prominent institutions will no longer accept donations from the family. However, neither the Sackler family nor top Purdue executives will face prison time as a result of the settlement.[1]

Did you know?

Purdue Pharma's corporate values are integrity, courage, innovation, and collaboration.

Obviously, organizations want to be seen as responsible corporate citizens and recognize the need to harmonize their operations with environmental demands and other social concerns. However, as shown in the opening vignette, not all firms have adopted a mindset that includes social responsibility and ethics in their strategies, decisions, and activities. Some managers still regard such business programs as a poor investment, in which the cost is not worth the return. Other managers—indeed, most managers—view the cost of these programs as a necessary business expense, similar to wages or rent.

Most managers today are finding ways to balance an agenda of socially responsible activities with the drive to generate profits. This also happens to be a good way for organizations to demonstrate their values and to attract like-minded employees, customers, and shareholders. In a highly competitive global business environment, an increasing number of companies are seeking to set themselves apart by developing a reputation for ethical and socially responsible behavior.

We begin this chapter by defining *business ethics* and examining ethical issues. Next, we look at the standards of behavior in organizations and how ethical behavior can be encouraged. We then turn to the topic of social responsibility. We explore the evolution of the idea of social responsibility, compare and contrast two present-day models of social responsibility, and present arguments for and against increasing the social responsibility of business. We then explore business responsibilities toward the public. Next, we discuss how social responsibility in business has affected employment practices and environmental concerns. Finally, we consider the commitment and planning that go into a firm's program of social responsibility.

2-1 Business Ethics Defined

Learning Objective

2-1 Define *business ethics*.

Ethics is the study of right and wrong and of the morality of the choices individuals make. An ethical decision or action is one that is "right" according to some standard of behavior. When there is strong consensus regarding a particular unethical action, society may demand laws to prohibit it. **Business ethics** is the application of moral standards to business situations. Recent court cases involving unethical behavior have helped make business ethics a matter of public concern. In one such case, concert promoter Billy McFarland was convicted of fraud, sentenced to six years in prison, and ordered to pay millions in restitution for bilking concert goers and investors of the Fyre Festival. Concert goers, who had paid as much as $100,000 to attend, were led to expect to hobnob with celebrities and models while enjoying lavish accommodations and popular bands, but found nothing of the kind when they arrived. McFarland also faces numerous lawsuits related to the ill-fated festival, and several celebrities who endorsed it on social media were fined.[2] While all unethical business actions do not result in fines and jail time, they do harm others by eroding trust in business decisions and decision makers. Regardless of their legality, all business decisions can be judged as right or wrong.

✓ Concept Check

- What is meant by business ethics?
- How do business ethics differ from personal ethics?

2-2 Ethical Issues In Business

Learning Objective

2-2 Identify the types of ethical concerns that arise in the business world.

Ethical issues often arise out of a business's relationships with investors, customers, employees, creditors, suppliers, or competitors. Each of these stakeholder groups has specific concerns and usually exerts pressure on the organization's managers. Investors, for example, want management to make sensible financial decisions that will boost sales, profits, and returns on their investments. Customers expect a firm's products to be safe, reliable, and reasonably priced. Employees demand to be treated fairly in hiring, promotion, and compensation decisions. Creditors require accounts to be paid on time and the accounting information furnished by the firm to be accurate. Competitors expect the firm's competitive practices to be fair and honest. Chick-fil-A, for example, sued 17 chicken suppliers, including Tyson Foods, Perdue Farms, and Pilgrim's Pride, accusing them of price-fixing—colluding to keep the prices it pays for poultry artificially high. The fast-food restaurant chain contends that the suppliers engaged in anticompetitive behavior by conspiring to share confidential bidding and pricing information in order to sustain higher chicken prices, resulting in consumers paying more for inferior chicken. A court will have to resolve the dispute.[3]

Businesspeople face ethical issues every day, and some of these issues can be difficult to assess. Although some types of issues arise infrequently, others occur regularly. Let's take a closer look at several ethical issues.

2-2a Fairness and Honesty

Fairness and honesty in business are two important ethical concerns. Besides obeying all laws and regulations, businesspeople are expected to refrain from knowingly deceiving, misrepresenting, or intimidating others. The consequences of failing to do so can be expensive. For example, NeuroMetrix, Inc., paid more than $4 million to settle Federal Trade Commission (FTC) charges that it deceptively promoted its Quell electrical nerve stimulation device. The commission claimed the company misled customers when it falsely touted the device as "clinically proven" and "Food and Drug Administration (FDA) cleared" for treating pain, when it was neither. In addition to the fine, the company and its marketers were ordered not to make any further false or misleading claims about the product.[4]

ethics the study of right and wrong and of the morality of the choices individuals make

business ethics the application of moral standards to business situations

If consumers feel they have been deceived or that companies have been unfair, they will take their business elsewhere and may even ask regulators to intervene. For instance, the Securities and Exchange Commission (SEC) charged the stock-trading app Robinhood with giving customers misleading information about the actual costs of trading with the app and failing to obtain the best reasonably available terms to execute their orders. The SEC blamed the app for depriving customers of $34 million in total. Robinhood paid $65 million to settle the case and updated its procedures to ensure that it executes the best trades possible for its users.[5]

FIZKES/SHUTTERSTOCK.COM

2-2b **Organizational Relationships**

Businesspeople may be tempted to place their personal welfare above the welfare of others or the welfare of the organization. As an example, Kristin M. Lapree was convicted of misappropriating more than $700,000 of funds while she worked as the business manager of Wisconsin-based Rettler Corporation. She was sentenced to six years in prison and ordered to pay restitution.[6] Aside from the legality of such actions, they may threaten the livelihood of employees and the business itself and harm relations with customers, suppliers, and others.

Relationships among co-workers often create ethical problems. Unethical behavior in these areas includes taking credit for others' ideas or work, not meeting one's commitments in a mutual agreement, and pressuring others to behave unethically. Managers and executives have even more power to pressure others due to their ability to provide rewards and sanctions. Consider Wells Fargo, which suffered incalculable damage to its reputation after investigators revealed that managers had pressured employees to achieve unrealistic sales quotas, which led many bank employees to open fake accounts for customers without their knowledge. The company ultimately paid billions of dollars to settle criminal and civil charges; several of its executives also face charges as a result of the scandal.[7] The Global Business Ethics Survey reported that 22 percent of workers around the world say

AVN PHOTO LAB/SHUTTERSTOCK.COM

Ethics violations Ethics violations can be more than humiliating. Ethics violators sometimes go to prison, pay large fines, lose their jobs, lose their families, and pay expensive legal fees.

they feel pressured to compromise their organization's ethics guidelines and policies, or to break the law; in North America, that value is 31 percent.[8]

One issue related to fairness and honesty is **plagiarism**—knowingly taking someone else's words, ideas, or other original material without acknowledging the source. When exposed, the consequences of plagiarism can be grave. For example, the U.S. Army War College rescinded the master's degree that it had awarded U.S. Senator John Walsh after an academic review by the college determined that Walsh had copied significant parts of his final paper from other sources. Walsh withdrew from his reelection campaign soon after the scandal.[9]

When misconduct occurs in business, investors also suffer. Investors and owners must be able to trust that companies are acting in their best interests and reporting their activities truthfully. They have the right to expect that all actions by a firm contribute toward a return on their investment. Two issues that raise flags for investors are executive compensation packages that are out of line with performance and the conflict of interest that may occur when a chief executive officer also sits on the board of directors—the group that oversees the CEO. In recent years, investors have protested high executive compensation, particularly when those executives do not generate strong profits for the owners. Shareholders have voted against executive compensation packages at a number of companies, including Electronic Arts, Ameriprise, Disney, and more.[10] Activist investors have also protested companies whose CEOs also sit on the board of directors, which can result in a conflict of interest when the CEO's performance is under review.

2-2c Conflicts of Interest

A **conflict of interest** results when businesspeople take advantage of a situation for their own personal interest rather than for the employer's interest. Examples of situations involving conflicts of interest generally involve an employee who has divided loyalties, such as a manager who is dating a subordinate, an employee with a close relative who works for a competitor, a purchasing manager who chooses to do business with another firm in which he is an investor, or a firm that advises clients without informing them that it has a relationship with some of the products it recommends. Even the appearance of a conflict of interest can jeopardize a businessperson's credibility. As an example, Louis DeJoy came under fire for failing to divest his ownership shares of XPO Logistics—where he previously served as CEO and chairman—when he was appointed Postmaster General by then President Donald Trump. His continued equity stake in XPO, a transportation and logistics firm that has million-dollar contracts with the U.S. Postal Service, created a conflict of interest for him when making shipping decisions for the federal agency. After the backlash, DeJoy agreed to sell his XPO stock.[11] In such cases, consumers and taxpayers have the right to know whether the head of a major government agency may be favoring certain contractors over others in order to benefit financially.

Conflicts of interest may occur when payments and gifts make their way into business deals. Although bribes—gifts, favors, or payments offered with the intent of influencing an outcome—are often part of business negotiations overseas, it is illegal for American businesspersons and companies to use bribes in the United States or abroad. Defending against bribery charges can be costly and affect future business negotiations. Herbalife Nutrition, for example, was fined $55 million for bribing Chinese officials to secure licenses required to engage in direct selling there and to influence investigations into its compliance with Chinese laws. Sales in China account for about 20 percent of the firm's global sales. Investigators also said the nutritional supplements marketer had doctored its records to hide the bribes, which are illegal under the U.S. Foreign Corrupt Practices Act. In addition to the fine, the company must give back $67 million of unlawful profits and interest, and two of its executives face related criminal and civil charges.[12] A wise rule to remember is

plagiarism knowingly taking someone else's words, ideas, or other original material without acknowledging the source

conflict of interest when businesspeople take advantage of a situation for their own personal interest rather than for the employer's interest that anything given to a person that might unfairly influence that person's business decision is a bribe, and all bribes are unethical.

At Procter & Gamble (P&G), all employees are obligated to act solely in the best interests of the company. P&G defines a conflict of interest as when an employee has a personal relationship or financial or other interest that could interfere with this obligation, or when employees use their position with the company for personal gain. The company requires employees to disclose all potential conflicts of interest and to take prompt actions to eliminate a conflict when the company asks them to do so. Generally, P&G prohibits employees from receiving gifts, entertainment, or other gratuities from people with whom the company does business because doing so could imply an obligation on the part of the company and potentially pose a conflict of interest.[13]

2-2d **Communications**

Business communications, especially advertising, can present ethical questions. False and misleading advertising is illegal and unethical, and it can infuriate customers. For example, angry consumers filed suit against the Folger Coffee Company, arguing that 30.5 ounce canisters of Folgers ground coffee claim to contain enough to make 240 servings, but actually hold just 173 servings when prepared according to the instructions on the canister. Disgruntled consumers have filed similar lawsuits against other coffee makers.[14] In another example, the Federal Trade Commission fined Williams-Sonoma $1 million and ordered the retailer to stop claiming that some products sold in Williams-Sonoma and Pottery Barn stores are "Made in USA," when they contained significant imported components.[15] Sponsors of advertisements aimed at children must be especially careful to avoid misleading messages. Advertisers of health-related products also must take precautions to guard against deception when using such descriptive terms as *low fat, fat free,* and *light*. In fact, the Federal Trade Commission has issued guidelines on the use of these labels.

✓ Concept Check

- What are the different types of ethical concerns that may arise in the business world?
- Explain and give an example of how advertising can present ethical questions.

Entrepreneurial Success

Building a Healthy Relationship with Social Media

Social media has long been criticized for its negative impact on society. For example, algorithms are often designed to manipulate users to stay on social networks as long as possible. It has also had immeasurable implications for data privacy. But despite these downfalls, social media still holds value for entrepreneurs as a source of inspiration, tools, insights, and community. With just a few simple changes, entrepreneurs can build a healthier relationship with social media.

For startups, establishing a brand on social media is critical, and an opportunity exists for creative, thoughtful engagement. However, it's important to be in control of your tech environment. Many apps allow users to reduce their screen time. A tool called Mailbrew rounds up social feeds and email newsletters into a single daily digest, and an app called Freedom blocks distracting apps on desktop and mobile devices to help users be more productive. Utilizing such resources can help you become the master of your devices.

Entrepreneurs can also set a positive example for their team members by promoting work-life balance and setting clear parameters for "on" and "off" times. Many entrepreneurs work around the clock, so it can be challenging to step away from the laptop and call it a day. But, by protecting off hours, entrepreneurs can cultivate a more productive work environment. In the end, unplugging can be positive for mental health and help people replenish their energy.

It's up to the next generation of business owners to disrupt the social media cycle. Rather than calling it quits, entrepreneurs can redefine their connection with their devices and build a healthier relationship with social media.

Sources: Based on information in Aytekin Tank, "How Entrepreneurs Can Harness The Power of Social Media for Good," *Entrepreneur*, October 22, 2020, www.entrepreneur.com/article/357208; Adi Robertson, "Telling People to Delete Facebook Won't Fix the Internet," *The Verge*, September 4, 2020, www.theverge.com/2020/9/4/21419993/the-social-dilemma-jeff-orlowski-netflix-movie-review-social-media-algorithms.

2-3 Factors Affecting Ethical Behavior

Learning Objective

2-3 Discuss the factors that affect the level of ethical behavior in organizations.

Is it possible for an individual with strong moral values to make ethically questionable decisions in a business setting? What factors affect a person's inclination to make either ethical or unethical decisions in a business organization? Although the answers to these questions are not entirely clear, three general sets of factors do appear to influence the standards of behavior in an organization.[16] As shown in Figure 2-1, these include individual factors, social factors, and opportunities.

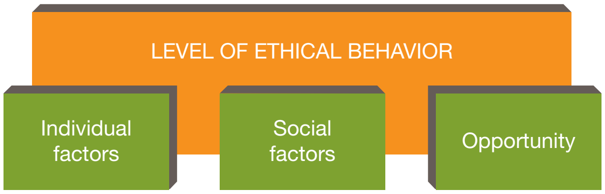
2-3a Individual Factors Affecting Ethics

Several factors influence an individual's ethical choices and behavior in an organization, including personal knowledge, values, and goals. How much an individual knows about an issue is one factor. A decision maker with a greater amount of knowledge regarding a situation may take steps to avoid ethical problems, whereas a less-informed person may unknowingly make choices that could lead to ethical problems. Individuals' moral values and central, value-related attitudes also clearly influence their business behavior and choices. Most organizations do not try to change an employee's personal ethics but instead strive to hire people with good character and values that complement their own. The actions of specific individuals in scandal-plagued companies, such as Wells Fargo, Volkswagen, Theranos, Turing Pharmaceuticals, and Enron, often raise questions about individuals' personal character and integrity. Finally, most people join organizations to accomplish personal goals. The types of personal goals an individual aspires to and how they choose to pursue them have a significant impact on that individual's behavior in an organization.

2-3b Social Factors Affecting Ethics

Many social factors can affect ethical behavior within a firm, including cultural norms, actions and decisions of co-workers, values and attitudes of "significant others," and the use of the internet. A person's behavior in the workplace, to some degree, is determined by cultural norms, and these social factors vary from one culture to another. For example, in some countries it is acceptable and ethical for customs agents to receive gratuities for performing ordinary, legal tasks that are a part of their jobs, whereas in other countries these practices would be viewed as unethical and perhaps illegal. The actions and decisions of co-workers may also shape a person's sense of business ethics. For example, if your co-workers peruse YouTube and Instagram on company time and at company expense, you might come to view that behavior as acceptable and ethical because everyone does it. The moral values and attitudes of "significant others"—spouses, friends, and relatives,

Figure 2-1 Factors That Affect the Level of Ethical Behavior in an Organization



Source: Based on O. C. Ferrell and Larry Gresham, "A Contingency Framework for Understanding Ethical Decision Making in Marketing," *Journal of Marketing* (Summer 1985), 89.

for instance—also can affect an employee's perception of what is ethical and unethical behavior in the workplace.

The internet also presents challenges for firms whose employees enjoy easy access through convenient high-speed connections at work. An employee's behavior online can be viewed as offensive to co-workers and possibly lead to lawsuits against the firm if employees engage in unethical behavior on controversial websites not related to their job. Moreover, if an employee posts controversial content on social media using their employer's email, Instagram, or Twitter account, that content may run counter to the company's core values and reflect negatively on the company. Interestingly, one recent survey of employees found that most workers assume that their use of technology at work will be monitored. A large majority of employees approved of most monitoring methods such as monitoring faxes and email, tracking Web use, and even recording telephone calls.

RAWPIXEL.COM/SHUTTERSTOCK.COM

2-3c **Opportunity as a Factor Affecting Ethics**

Several factors related to opportunity affect ethics in an organization. *Opportunity* refers to the amount of freedom an organization affords an employee to behave unethically if he or she makes that choice. If the employee is rewarded in some way for an unethical choice—receiving praise or a bonus, for example—or fails to suffer any kind of consequence, he or she is more likely to make that same choice in the future. In some organizations, certain company policies and procedures reduce the opportunity to be unethical. For example, at some fast-food restaurants, one employee takes your order and receives your payment, and another fills the order. This procedure reduces the opportunity to be unethical because the person handling the money is not dispensing the product, and the person giving out the product is not handling the money.

The existence of codes of ethics and other policies on ethics, as well as the importance management places on these policies are other elements of opportunity (codes of ethics are discussed in more detail in the next section). The degree of enforcement of company policies, procedures, and ethical codes is a major force affecting opportunity. When employees see that violations are dealt with consistently and firmly, they are less likely to act unethically knowing that doing so will bring repercussions.

Now that we have considered some of the factors believed to influence the level of ethical behavior in the workplace, let us explore what can be done to encourage ethical behavior and to discourage unethical behavior.

✓ Concept Check

- Describe several individual factors that influence the level of ethical behavior in an organization.
- Explain several social factors that affect ethics in an organization.
- How does opportunity influence the level of ethical behavior in the workplace?

2-4 Encouraging Ethical Behavior

Learning Objective

2-4 Explain how organizations can encourage ethical decision making in business.

Most authorities agree that there is room for improvement in business ethics. A more problematic question is: Can business be made more ethical in the real world? The majority opinion on this issue suggests that government, trade associations, and individual firms indeed can promote acceptable levels of ethical behavior.

2-4a **Government's Role in Encouraging Ethics**

The government can encourage ethical behavior in business by enacting more stringent regulations and laws. One example is the landmark **Sarbanes-Oxley Act of 2002**, which provides sweeping legal protection for those who report corporate misconduct. Among other things, the law deals with corporate responsibility,

Sarbanes-Oxley Act of 2002 provides sweeping legal protection for employees who report corporate misconduct

Sarbanes-Oxley Act The Sarbanes-Oxley Act of 2002 includes tough provisions to deter and punish corporate and accounting fraud and corruption. The legislation passed with unanimous support.

INDYPENDENZ/SHUTTERSTOCK.COM

conflicts of interest, and corporate accountability. However, rules require enforcement, and the unethical businessperson frequently seems to "slip something by" without getting caught. Increased regulation may help, but it cannot solve the entire ethics problem.

2-4b Trade Associations' Role in Encouraging Ethics

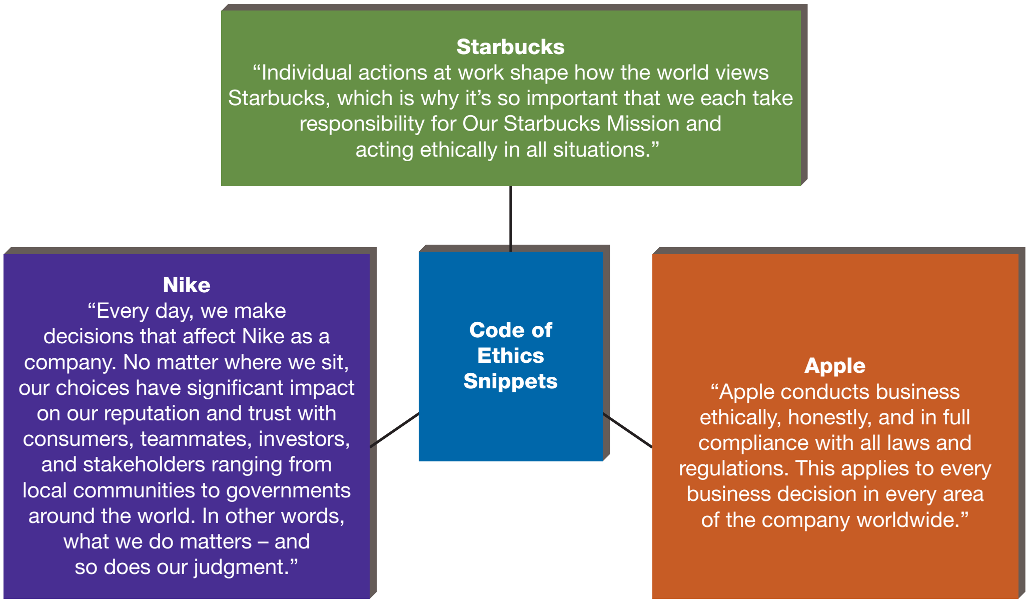
Trade associations can and often do provide ethical guidelines for their members. These organizations, which operate within particular industries, are in an excellent position to exert pressure on members to stop engaging in questionable business practices that may harm all firms in the industry. For example, a pharmaceutical trade group adopted a new set of guidelines intended to end the extravagant dinners and expensive gifts sales representatives often give to physicians to persuade them to prescribe a particular medicine. However, enforcement and authority vary from association to association. Because trade associations exist for the benefit of their members, harsh measures may be self-defeating. Trade associations must also ensure that their codes do not contain provisions that may run afoul of antitrust laws.

2-4c Individual Companies' Role in Encouraging Ethics

Enforced codes of ethics are perhaps the most effective way to encourage ethical behavior within organizations. A **code of ethics** is a written guide to acceptable and ethical behavior as defined by an organization; it outlines uniform policies, standards, and punishments for violations. Because a code of ethics informs employees what is expected of them and what will happen if they violate the rules, it can go a long way toward encouraging ethical behavior. However, codes cannot possibly cover every situation. Companies also must create an environment in which employees recognize the importance of complying with the written code. Managers must provide direction by fostering communication, actively modeling and encouraging ethical decision making, and training employees to make ethical decisions. However, codes that are not enforced are likely to be viewed as lip service by employees and other stakeholders. Figure 2-2 offers snippets of some of the guiding principles behind well-known companies' codes of ethics.

code of ethics a guide to acceptable and ethical behavior as defined by the organization

Figure 2-2 **Defining Acceptable Behavior at Starbucks, Nike, and Apple**



Code of Ethics Snippets

Starbucks
"Individual actions at work shape how the world views Starbucks, which is why it's so important that we each take responsibility for Our Starbucks Mission and acting ethically in all situations."

Nike
"Every day, we make decisions that affect Nike as a company. No matter where we sit, our choices have significant impact on our reputation and trust with consumers, teammates, investors, and stakeholders ranging from local communities to governments around the world. In other words, what we do matters – and so does our judgment."

Apple
"Apple conducts business ethically, honestly, and in full compliance with all laws and regulations. This applies to every business decision in every area of the company worldwide."

Sources: Starbucks, "Business Ethics and Compliance: Standards of Business Conduct," https://www.starbucks.ph/media/Business-Ethics-and-Compliance-eng_tcm70-11290.pdf (accessed January 21, 2021); Nike, "Inside the Lines: The NIKE Code of Ethics," p. 1, https://s1.q4cdn.com/806093406/files/doc_downloads/2019/05/Nike-Inside-the-Lines-Code-of-Conduct_May-2019.pdf (accessed January 21, 2021); Apple, "Business Conduct: The Way We Do Business Worldwide," p. 3, https://s2.q4cdn.com/470004039/files/doc_downloads/Business-Conduct-Policy.pdf (accessed January 21, 2021).

Beginning in the 1980s, an increasing number of organizations created and implemented ethics codes. Today, about 95 percent of *Fortune* 1000 firms have a formal code of ethics or conduct. For example, the ethics code of Starbucks defines the firm's mission and values and includes provisions relating to policies and procedures; laws and regulations; relationships with customers, suppliers, competitors, and the community; conflicts of interest; handling of proprietary information; and more. Starbucks' code also details how employees can express concerns or find guidance in ambiguous situations and even provides a graphical decision-making framework that employees can apply to difficult decisions.[17]

In the wake of a number of corporate scandals and the Sarbanes-Oxley Act, many large companies now have created a new executive position, the chief ethics (or compliance) officer. Assigning an ethics officer who guides ethical conduct provides employees someone to consult if they are not sure of the right thing to do. An ethics officer meets with employees and top management to provide ethical advice, establishes and maintains an anonymous confidential service to answer questions about ethical issues, and takes action on ethics code violations.

Sometimes even employees who want to act ethically may find it difficult to do so. Unethical practices can become ingrained in an organization. Employees with high personal ethics may then take a controversial step called *whistle-blowing*. **Whistle-blowing** is informing the press or government officials about unethical practices within an organization. Consider Teresa Ross, who brought a lawsuit against Group Health Cooperative (GHC, now Kaiser Foundation Health Plan's Washington subsidiary) under the False Claims Act, which permits whistle-blowers to sue companies they believe have defrauded the government. Ross, who worked as Director of Risk Adjustment Services for the healthcare firm, believed that GHC was defrauding Medicare by inflating or altering patients' diagnoses in order to receive

whistle-blowing informing the press or government officials about unethical practices within one's organization

Exploring Careers

The Rise of the Chief Ethics Officer

With artificial intelligence (AI) applications spreading throughout the business world, executives now rank ethics issues as one of the top risks of AI. Bias, for instance, can find its way into AI algorithms, which can lead to discrimination. This mounting concern has contributed to the rise of the chief ethics officer. Ethics officers are executives who provide oversight to guide the organization through legal and ethical standards.

Though the role does not have a set job description like other C-suite roles, some companies are looking to the chief ethics officer to ensure AI algorithms are fair and unbiased. AI has been integrated into a variety of functions, from recruiting and contact tracing to facial recognition and email marketing. Candidates for the chief ethics officer role may have a background in business law and human resources, though some tech departments are hiring dedicated AI ethics officers.

Due to a lack of regulation for AI development, it's up to companies to set their own standards and policies. The ethics officer can assess risks, create a code of ethics, conduct internal training programs, ensure compliance with regulations, monitor ongoing ethical conduct, and act on violations of the company's ethics code. In addition to AI, other tech issues to consider are privacy, data collection, and security. The chief ethics officer can play a critical part in eliminating bias, guarding against unintended consequences, and holding individuals and organizations accountable.

Sources: Based on information in "Rise of the Chief Ethics Officer," *Forbes*, March 27, 2019, www.forbes.com/sites/insights-intelai/2019/03/27/rise-of-the-chief-ethics-officer/; Geoff Nudelman, "20 Minutes With: Hypergiant Industries' Chief Ethics Officer Will Griffin on Diversity and Ethics in Technology," *Barron's*, September 7, 2020, www.barrons.com/articles/20-minutes-with-hypergiant-industries-chief-ethics-officer-will-griffin-on-diversity-and-ethics-in-technology-01599495907; Merve Hickok, "What Does an AI Ethicist Do? A Guide for the Why, the What, and the How," *Medium*, April 27, 2020, www.medium.com/@MerveHickok/what-does-an-ai-ethicist-do-a-guide-for-the-why-the-what-and-the-how-643e1bfab2e9.

higher payments. The company eventually settled the case with the Department of Justice for $6.3 million. Ross was awarded about $1.5 million for blowing the whistle.[18]

Whistle-blowing, however, can have serious repercussions for employees: Those who "blow the whistle" may face retaliation and sometimes even lose their jobs. The Sarbanes-Oxley Act of 2002 protects whistle-blowers who report corporate misconduct. Any executive who retaliates against a whistle-blower can be held criminally liable and imprisoned for up to ten years. Federal employees who report misconduct are likewise protected by the Whistleblower Protection Act of 1989.

When companies set up anonymous hotlines to advise employees who are unsure how to handle ethically questionable situations, employees actually may be more likely to engage in whistle-blowing. When firms instead create an environment that educates employees and nurtures ethical behavior, fewer ethical problems arise. Ultimately, the need for whistle-blowing is greatly reduced.

It is difficult for an organization to develop ethics codes, programs, and procedures to deal with all relationships and every situation. Michael Josephson, an expert on workplace ethics, says, "The objective of such programs is to establish a business culture in which it's easier to do the right thing than the wrong thing, and where concerned co-workers and vigilant supervisors repress illegal or improper conduct that can potentially endanger or embarrass the company."[19] When no company policies or procedures exist or apply, a quick test to determine if a behavior is ethical is to see if others—co-workers, customers, and suppliers—approve of it. Ethical decisions will always withstand scrutiny. Openness and communication about choices will often build trust and strengthen business relationships. Table 2-1 provides some general guidelines for making ethical decisions.

✓ Concept Check

- How can the government encourage the ethical behavior of organizations?
- What is the role of trade associations in encouraging ethics?
- What is whistle-blowing? Who protects the whistle-blowers?

Table 2-1 Guidelines for Making Ethical Decisions

1. Listen and learn	Recognize the problem or decision-making opportunity that confronts your company, team, or unit. Don't argue, criticize, or defend yourself—keep listening and reviewing until you are sure that you understand others.
2. Identify the ethical issues	Examine how co-workers and consumers are affected by the situation or decision at hand. Examine how you feel about the situation, and attempt to understand the viewpoint of those involved in the decision or in the consequences of the decision.
3. Create and analyze options	Try to put aside strong feelings such as anger or a desire for power and prestige and come up with as many alternatives as possible before developing an analysis. Ask everyone involved for ideas about which options offer the best long-term results for you and the company. Then decide which option will increase your self-respect even if, in the long run, things don't work out the way you hope they will.
4. Identify the best option from your point of view	Consider it and test it against some established criteria, such as respect, understanding, caring, fairness, honesty, and openness.
5. Explain your decision and resolve any differences that arise	This may require neutral arbitration from a trusted manager or taking "time out" to reconsider, consult, or exchange written proposals before a decision is reached.

Source: Based on information in Tom Rusk with D. Patrick Miller, "Doing the Right Thing," *Sky* (Delta Airlines), August 1993, 18–22.

2-5 Social Responsibility

Learning Objective

2-5 Describe how our current views on the social responsibility of business have evolved.

Social responsibility is the recognition that business activities have an impact on society and the consideration of that impact in business decision making. Alphabet and its subsidiary Google, for example, have pledged to donate $14.5 million to support initiatives to combat racial injustice, inequity, and violence, including grants to the Center for Policing Equity and Equal Justice Initiative.[20] Obviously, social responsibility costs money. It is perhaps not so obvious—except in isolated cases—that social responsibility is also good business. Many companies contribute resources, knowledge, and products as well as money to help neighbors and others during times of crisis. For example, Procter & Gamble's orange Loads of Hope trucks are a welcome sight during disaster relief efforts. Residents in disaster areas can drop off loads of dirty laundry at the mobile laundromats, and volunteers use Tide products and high-efficiency machines to wash, dry, and even fold their clothes. Thus far, the program has helped nearly 48,000 families and brought a sense of normalcy and hope back to survivors so that they can focus on more pressing matters.[21] Efforts like these bring positive associations for brands that can help them stand out in a competitive market. Customers eventually find out which firms act responsibly and which do not. Just as easily as they can purchase a product made by a company that is socially responsible, they can choose against buying from the firm that is not.

social responsibility the recognition that business activities have an impact on society and the consideration of that impact in business decision making

Even small businesses can develop social responsibility programs. For example, P. Terry's, which operates 19 fast-food hamburger stands in Central Texas, donates 100 percent of its profits from one day each quarter to a local charity. The company, which has donated more than $1 million to local nonprofits, lets customers know about upcoming charity days through its social media accounts.[22] In general, people are more likely to want to work for and buy from such organizations.

Tide® Vintage T-shirts
Give Loads of Hope to families affected by disasters. And for a limited time, get an exclusive Faith Hill song download with your purchase.
Tide
Loads of Hope

SOURCE: WORDPRESS.COM

Social responsibility is good business. Natural disasters create opportunities for companies to engage in socially responsible behavior. Procter & Gamble's Loads of Hope program takes in disaster survivors' dirty laundry and returns it to them clean and folded, allowing them to deal with more important problems.

Table 2-2 10 Best Corporate Citizens

1. Owens Corning
2. Citi
3. General Mills
4. Cisco
5. HP
6. Intel
7. Ecolab
8. General Motors
9. Hess
10. Accenture

Source: "100 Best Corporate Citizens of 2020," *3BL Media*, https://100best.3blmedia.com/ (accessed January 21, 2021).

Increasingly, companies large and small are striving to be good corporate citizens. **Corporate citizenship** is adopting a strategic approach to fulfilling economic, ethical, environmental, and social responsibilities. This requires balancing the needs, desires, and demands of a diverse group of stakeholders including investors, employees, customers, regulators, competitors, neighborhoods and communities, and social activists. Consider Chris Kempczinski, president and CEO of McDonald's, who views the company's role in society as going beyond feeding Big Macs to customers: "What we realized is that for 65 years, McDonald's purpose has been to both feed and foster communities. To our franchisees, suppliers and employees, the words 'billions served' aren't just about the burgers and fries we serve, but the tens of thousands of communities around the world that we serve." One way the company does that is through its longtime sponsorship of Ronald McDonald House Charities, which helps support the families of sick and injured children during treatment.[23] Table 2-2 lists the best corporate citizens as evaluated by 3BL Media.

2-5a The Evolution of Social Responsibility in Business

Business is far from perfect in many respects, but its record of social responsibility today is much better than that in past decades. In fact, present demands for social responsibility have their roots in outraged reactions to the abusive business practices of the early 1900s.

During the first quarter of the 20th century, businesses were free to operate pretty much as they chose. Government protection of workers and consumers was minimal. As a result, people either accepted what business had to offer or they did without. Working conditions often were deplorable by today's standards. The average workweek in most industries exceeded 60 hours, no minimum-wage law existed, and employee benefits were almost nonexistent. Workplaces were crowded and unsafe, and industrial accidents were the rule rather than the exception. To improve working conditions, employees organized and joined labor unions. During the early 1900s, however, businesses—with the help of government—were able to use court orders, brute force, and even the few existing antitrust laws to defeat union attempts to improve working conditions.

During this period, consumers generally were subject to the doctrine of **caveat emptor**, a Latin phrase meaning "let the buyer beware." In other words, "what you see is what you get," and if it is not what you expected, too bad. Although victims of unscrupulous business practices could take legal action, going to court was very expensive, and consumers rarely won their cases. Moreover, no consumer groups or government agencies existed to publicize their consumers' grievances or to hold sellers accountable for their actions.

Before the 1930s, most people believed that competition and the action of the marketplace would, in time, correct abuses. Government, therefore, became involved in day-to-day business activities only in cases of obvious abuse of the free-market system. Six of the most important business-related federal laws passed between 1887 and 1914 are described in Table 2-3. As you can see, these laws were aimed more at encouraging competition than at correcting abuses, although two of them did deal with the purity of food and drug products.

The collapse of the stock market on October 29, 1929, triggered the Great Depression. Factory production fell by almost half, and up to 25 percent of the nation's workforce was unemployed. Public pressure soon mounted for the government to "do something" about the economy and about worsening social conditions. Soon after Franklin D. Roosevelt became president in 1933, he instituted programs to restore the economy and improve social conditions. The government passed laws to correct what many viewed as the monopolistic abuses of big business, and provided various social services for individuals. These massive federal programs became the foundation for increased government involvement in the dealings between business and society.

corporate citizenship adopting a strategic approach to fulfilling economic, ethical, environmental, and social responsibilities

caveat emptor a Latin phrase meaning "let the buyer beware"

Table 2-3 **Early Government Regulations That Affected American Business**

Government Regulation	Major Provisions
Interstate Commerce Act (1887)	First federal act to regulate business practices; provided regulation of railroads and shipping rates
Sherman Antitrust Act (1890)	Prevented monopolies or mergers where competition was endangered
Pure Food and Drug Act (1906)	Established limited supervision of interstate sales of food and drugs
Meat Inspection Act (1906)	Provided for limited supervision of interstate sales of meat and meat products
Federal Trade Commission Act (1914)	Created the Federal Trade Commission to investigate illegal trade practices
Clayton Antitrust Act (1914)	Eliminated many forms of price discrimination that gave large businesses a competitive advantage over smaller firms

As government involvement has increased, so has everyone's awareness of the social responsibility of business. Today's business owners are concerned about the return on their investment, but at the same time most of them demand ethical behavior from employees. In addition, employees demand better working conditions, and consumers want safe, reliable products. Various advocacy groups echo these concerns and also call for careful consideration of the Earth's delicate ecological balance. Therefore, managers must operate in a complex business environment—one in which they are just as responsible for their managerial actions as for their actions as individual citizens. Interestingly, today's high-tech and internet-based firms fare relatively well when it comes to environmental issues, worker conditions, animal testing, and charitable donations.

2-5b Two Views of Social Responsibility

Government regulation and public awareness are *external* forces that have increased the social responsibility of business. However, business decisions are made within the firm—there, social responsibility begins with the attitude of management. Two contrasting philosophies, or models, define the range of management attitudes toward social responsibility.

According to the traditional concept of business, a firm exists to produce quality goods and services, earn a reasonable profit, and provide jobs. In line with this concept, the **economic model of social responsibility** holds that society will benefit most when business is left alone to produce and market profitable products that society needs. The economic model has its origins in the 18th century, when businesses were owned primarily by entrepreneurs or owner-managers. Competition was vigorous among small firms, and short-run profits and survival were the primary concerns. To the manager who adopts this traditional attitude, social responsibility is someone else's job. After all, stockholders invest in a corporation to earn a return on their investment, not because the firm is socially responsible, and the firm is legally obligated to act in the economic interest of its stockholders. Moreover, profitable firms pay federal, state, and local taxes that are used to meet the needs of society. Thus, managers who concentrate on profit believe that they fulfill their social responsibility indirectly through the taxes paid by their firms. As a result, social responsibility becomes the problem of the government, various environmental groups, charitable foundations, and similar organizations.

In contrast, some managers believe that they have a responsibility not only to stockholders but also to customers, employees, suppliers, and the general public. This broader view is referred to as the **socioeconomic model of social responsibility**, which places emphasis not only on profits but also on the impact of business decisions on society.

economic model of social responsibility the view that society will benefit most when business is left alone to produce and market profitable products that society needs

socioeconomic model of social responsibility the concept that business should emphasize not only profits but also the impact of its decisions on society

Recently, increasing numbers of managers and firms have adopted the socioeconomic model, and they have done so for at least three reasons. First, business is dominated by the corporate form of ownership, and the corporation is a creation of society. If a corporation does not perform as a good citizen, society can and will demand changes. Second, many firms have begun to take pride in their social responsibility records, among them Starbucks, HP, Colgate-Palmolive, and Coca-Cola. Of course, many other corporations are much more socially responsible today than they were ten years ago. Third, many businesspeople believe that it is in their best interest to take the initiative in this area. The alternative may be legal action brought against the firm by some special-interest group; in such a situation, the firm may lose control of its activities.

2-5c The Pros and Cons of Social Responsibility

Business owners, managers, customers, and government officials have debated the pros and cons of the economic and socioeconomic models for years. Each side seems to have four major arguments to reinforce its viewpoint.

Proponents of the socioeconomic model maintain that a business must do more than simply seek profits. To support their position, they offer the following arguments:

1. Because business is a part of our society, it cannot ignore social issues.
2. Business has the technical, financial, and managerial resources needed to tackle today's complex social issues.
3. By helping resolve social issues, business can create a more stable environment for long-term profitability.
4. Socially responsible decision making by firms can prevent increased government intervention, which would force businesses to do what they fail to do voluntarily.

These arguments are based on the assumption that a business has a responsibility not only to its stockholders but also to its customers, employees, suppliers, and the general public.

Opponents of the socioeconomic model argue that business should do what it does best: earn a profit by manufacturing and marketing products that people want. Those who support this position argue as follows:

1. Business managers are responsible primarily to stockholders, so management must be concerned with providing a return on owners' investments.
2. Corporate time, money, and talent should be used to maximize profits, not to solve society's problems.
3. Social problems affect society in general, so individual businesses should not be expected to solve these problems.
4. Social issues are the responsibility of government officials who are elected for that purpose and who are accountable to the voters for their decisions.

These arguments obviously are based on the assumption that the primary objective of business is to earn profits and that government and social institutions should deal with social problems.

Today, few firms are either purely economic or purely socioeconomic in outlook; most have chosen some middle ground between the two extremes. However, our society generally seems to want—and even to expect—some degree of social responsibility from business. Thus, within this middle ground, businesses are leaning toward the socioeconomic view. In the next several sections, we look at some results of this movement in four specific areas: the public, employment practices, the environment, and implementation of social responsibility programs.

✓ Concept Check

- What is social responsibility? How can business be socially responsible?
- Outline the historical evolution of business social responsibility.
- Explain two views on the social responsibility of business.
- What are the arguments for and against increased social responsibility?

2-6 Public Responsibilities of Business

In recent years, more businesses have adopted the idea that they have basic responsibilities to the public, particularly to consumers and public health.

Learning Objective

2-6 List the responsibilities businesses have to the public, especially with regard to consumer rights and public health.

2-6a Consumerism

Consumerism consists of all activities undertaken to protect the rights of consumers. The fundamental issues pursued by the consumer movement fall into three categories: environmental protection, product performance and safety, and information disclosure. Although consumerism has been with us to some extent since the early 19th century, the consumer movement became stronger in the 1960s. It was then that President John F. Kennedy declared that the consumer was entitled to a new "Bill of Rights."

The Basic Rights of Consumers President Kennedy's Consumer Bill of Rights asserted that consumers have a right to safety, to be informed, to choose, and to be heard. Two additional rights added since 1975 are the right to consumer education and the right to courteous service. These six rights are the basis of much of the consumer-oriented legislation passed during the last 55 years. These rights also provide an effective outline of the objectives and accomplishments of the consumer movement.

The consumers' right to safety means that the products they purchase must be safe for their intended use, must include thorough and explicit directions for proper use, and must be tested by the manufacturer to ensure product quality and reliability. Federal agencies, such as the Food and Drug Administration and the Consumer Product Safety Commission, have the power to force businesses that make or sell defective products to take corrective actions such as offering refunds, recalling defective products, issuing public warnings, and reimbursing consumers—all of which can be expensive. Moreover, consumers and the government have been winning an increasing number of product-liability lawsuits against sellers of defective products. The amount of the awards in these suits has been increasing steadily. For example, a Florida man won $41.1 million when he sued R.J. Reynolds Tobacco Company and Phillip Morris USA, claiming that for decades they had concealed the hazards of smoking, which led him to develop severe COPD.[24] Yet another major reason for improving product safety is consumers' demand for safe products. People simply will stop buying a product they believe is unsafe or unreliable.

consumerism all activities undertaken to protect the rights of consumers

The right to be informed means that consumers must have access to complete information about a product before they buy it. Detailed information about ingredients and nutrition must be provided on food containers, information about fabrics and laundering methods must be attached to clothing, and lenders must disclose the true cost of borrowing the money they make available to customers who purchase merchandise on credit. In addition, manufacturers must inform consumers about the potential dangers of using their products. Manufacturers that fail to provide such information can be held responsible for personal injuries suffered because of their products. For example, Maytag provides customers with a lengthy booklet that describes how they should use their new washing

The right to safety The Consumer Bill of Rights asserts buyers' basic rights. The right to safety means that products must be safe for their intended use and tested by the producer to ensure product quality and safety.

MICROGEN/SHUTTERSTOCK.COM

machines. Sometimes such warnings seem excessive, but they are necessary if user injuries (and resulting lawsuits) are to be avoided.

The right to choose means that consumers must have a choice of products, offered by different manufacturers and sellers, to satisfy a particular need. The government has done its part by encouraging competition through antitrust legislation. The greater the competition, the greater is the choice available to consumers. Competition and the resulting freedom of choice provide additional benefits for customers by reducing prices. For example, when personal computers were introduced, they cost more than $5,000. Thanks to intense competition and technological advancements, personal computers today can be purchased for less than $500.

The right to be heard means that someone will listen and take appropriate action when customers complain. In fact, management began to listen to consumers after World War II, when competition between businesses that manufactured and sold consumer goods increased. One way that firms gained a competitive edge was to listen to consumers and provide the products they said they wanted and needed. Today, businesses are listening even more attentively, and many larger firms have consumer relations departments that can be contacted easily via email and social media. Other groups listen, too. Most large cities and some states have consumer affairs offices to act on citizens' complaints.

In 1975, President Gerald Ford added to the Consumer Bill of Rights *the right to consumer education,* which entitles people to be fully informed about their rights as consumers. In 1994, President Bill Clinton added a sixth right, *the right to service,* which entitles consumers to convenience, courtesy, and responsiveness from manufacturers and sellers of consumer products.

Ethics and Social Responsibility

Google Sued for Antitrust Violations

Google, the world's largest search engine and one of the largest companies in the United States, faces a series of lawsuits centered around anticompetitive behavior. The Department of Justice and 11 state attorneys general filed a lawsuit against the company to prevent it from using anticompetitive practices to maintain its monopolies in the search and search advertising markets. Anticompetitive behavior negatively affects both consumers and competitors. Among other things, stifling competition inhibits innovation and reduces the options available to consumers.

Complaints against the tech giant include entering into exclusionary agreements that prohibit preinstallation of competing search services and using monopoly profits to pay for preferential treatment for its products. Google has responded to the lawsuit, saying it believes there is nothing wrong with its business agreements. A separate case from more than 30 states alleges Google uses its general search monopoly to discriminate against vertical search companies like Yelp and Kayak. A third lawsuit from a smaller group of states alleges Google uses its position in the advertising marketplace to create unfair conditions for advertisers and publishers, taking in a higher percentage of online ad spending.

Though on a surface level it may seem Google is being targeted for being successful, the accusations made against the company are serious. The distinction between competitive behavior and anticompetitive behavior is that being competitive relates to efforts taken to become the best while being anticompetitive relates to suppressing the competition. Antitrust laws are intended to promote competition and protect consumers. Lawsuits such as the ones Google faces stand to reshape the tech industry.

Sources: Based on information in Department of Justice, "Justice Department Sues Monopolist Google For Violating Antitrust Laws," October 20, 2020, www.justice.gov/opa/pr/justice-department-sues-monopolist-google-violating-antitrust-laws; Gilad Edelman, "Google's Antitrust Cases: A Guide for the Perplexed," *Wired*, December 18, 2020, www.wired.com/story/google-antitrust-lawsuits-explainer/; Federal Trade Commission, "Guide to Antitrust Laws," www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws.

Major Consumerism Forces The major forces in consumerism are individual consumer advocates and organizations, consumer education programs, and consumer laws. Consumer advocates take it upon themselves to protect the rights of consumers. They band together into consumer organizations, either independently or under government sponsorship. They write letters and advocate for stricter legislation concerning practices that may harm consumers. In Europe, for example, some consumer groups have complained to regulators that Amazon's Prime membership service is difficult to cancel, manipulating users into sticking with a plan they no longer want. Public Citizen, a consumer group in the United States, has made a similar complaint to the Federal Trade Commission.[25] Some consumer advocates and organizations encourage consumers to boycott products and businesses to which they have objections.

Educating consumers to make wiser purchasing decisions is perhaps one of the most far-reaching aspects of consumerism. Increasingly, consumer education is becoming a part of high school and college curricula and adult education programs. These programs cover many topics—for instance, what major factors should be considered when buying specific products, such as insurance, real estate, automobiles, appliances and furniture, clothes, and food; the provisions of certain consumer-protection laws; and the sources of information that can help individuals become knowledgeable consumers.

Major advances in consumerism have come through federal legislation. Some laws enacted in the last 60 years to protect your rights as a consumer are listed and described in Table 2-4.

Most businesspeople now realize that they ignore consumer issues only at their own peril. Managers know that improper handling of consumer complaints can result in lost sales, bad publicity, and lawsuits.

2-6b Public Health

Many people believe that businesses have a basic responsibility to contribute to the general well-being of the public, starting with ensuring that their products do not harm anyone. Beyond this basic responsibility, however, there is disagreement as to how far businesses' responsibility to public health should extend, especially about issues such as obesity, smoking, heart disease, alcohol use, and even smartphone use while driving. These issues are not black and white, but exploring them can help us find balance among the desires and demands of various stakeholders.

Obesity has become a major public health topic in recent years, with more than one-third of adult Americans being categorized as obese. Other countries are experiencing similar trends. People who are obese or significantly overweight face higher rates of diabetes, strokes, heart disease, and some types of cancer, and the swelling numbers of these illnesses place a great burden on the healthcare system, the costs of which are borne by society. Public health advocates have called for companies—particularly those that market sugary drinks and fast food—to modify their products or at least their advertising in an effort to reduce the consumption of these products, which have been shown to contribute to rising rates of obesity. Perhaps as a result, some producers of these products have suffered losses and are responding with new ideas and products. Coca-Cola, for example, discontinued hundreds of brands, including some with higher levels of sugar, such as Odwalla. In recent years, the beverage giant has introduced or acquired new beverage brands such as Fairlife milk, Simply juices, and Topo Chic mineral waters that have less sugar and/or provide health benefits.[26] Other companies, including Panera and Starbucks, are posting the calories in their offerings right on their menus and apps to help people make better choices.

Another major public health topic facing business relates to smoking and tobacco products. The relationship between smoking—even secondhand smoke—and cancer has been well documented, but some consumers still demand to buy cigarettes and tobacco

Table 2-4 Major Federal Legislation Protecting Consumers Since 1960

Legislation	Major Provisions
Federal Hazardous Substances Labeling Act (1960)	Required warning labels on household chemicals if they were highly toxic
Kefauver-Harris Drug Amendments (1962)	Established testing practices for drugs and required manufacturers to label drugs with generic names in addition to trade names
Cigarette Labeling Act (1965)	Required manufacturers to place standard warning labels on all cigarette packages and advertising
Fair Packaging and Labeling Act (1966)	Called for all products sold across state lines to be labeled with net weight, ingredients, and manufacturer's name and address
Motor Vehicle Safety Act (1966)	Established standards for safer cars
Truth in Lending Act (1968)	Required lenders and credit merchants to disclose the full cost of finance charges in both dollars and annual percentage rates
Credit Card Liability Act (1970)	Limited credit card holder's liability to $50 per card and stopped credit card companies from issuing unsolicited cards Required credit bureaus to provide credit reports to consumers regarding their own credit files; also provided for correction of incorrect information
Consumer Product Safety Commission Act (1972)	Established an abbreviated procedure for registering certain generic drugs
Fair Credit Billing Act (1974)	Amended the Truth in Lending Act to enable consumers to challenge billing errors
Equal Credit Opportunity Act (1974)	Provided equal credit opportunities for all individuals regardless of sex or marital status Provided for minimum disclosure standards for written consumer-product warranties for products that cost more than $15
Amendments to the Equal Credit Opportunity Act (1976, 1994)	Prevented discrimination based on race, creed, color, religion, age, and income when granting credit
Fair Debt Collection Practices Act (1977)	Outlawed abusive collection practices by third parties
Nutrition Labeling and Education Act (1990)	Required the Food and Drug Administration to review current food labeling and packaging focusing on nutrition label content, label format, ingredient labeling, food descriptors and standards, and health messages
Telephone Consumer Protection Act (1991)	Prohibited the use of automated dialing and prerecorded voice calling equipment to make calls or deliver messages
Consumer Credit Reporting Reform Act (1997)	Placed more responsibility for accurate credit data on credit issuers; required creditors to verify that disputed data are accurate and to notify a consumer before reinstating the data
Children's Online Privacy Protection Act (2000)	Placed parents in control over what information is collected online from their children younger than 13 years; required commercial website operators to maintain the confidentiality, security, and integrity of personal information collected from children
Do Not Call Implementation Act (2003)	Directed the FCC and the FTC to coordinate so that their rules are consistent regarding telemarketing call practices including the Do Not Call Registry and other lists, as well as call abandonment
Credit Card Accountability, Responsibility, and Disclosure Act (2009)	Provided the most sweeping changes in credit card protections since the Truth in Lending Act of 1968
Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010	Promoted the financial stability of the United States by improving accountability and responsibility in the financial system; established a new Consumer Financial Protection Agency to regulate home mortgages, car loans, and credit cards; became Public Law on July 21, 2010

products. While most people agree that businesses should not knowingly sell products that harm customers, what should they do when consumers continue to demand those products? CVS Health earned significant publicity several years ago when it announced that it would stop selling cigarettes in its stores, even though it lost $2 billion in revenue from doing so.[27] In recent years, the rise of vaping has further compounded the issue. Marketers of e-cigarettes and vaping products insist that their products are safer than cigarettes and even tout them as a method to stop smoking. Health advocates, however, say they are still harmful, and worry that the vapors—which often come in flavors such as bubblegum and pina colada—may be especially attractive to minors. Some cities have banned e-cigarettes along with conventional ones, and federal regulators are studying the devices to determine whether further regulation is needed.

One growing concern is the use of smartphones and smartphone apps while driving. Should cell phone service providers take steps to prevent customers from texting and using apps that distract from driving or merely advise them to refrain from these activities? AT&T launched its "It Can Wait" promotion campaign to ask customers to avoid texting while driving, and more than 38 million users pledged not to. The cell phone service provider asked customers to use the hashtag #X to alert their friends and followers that they are about to be unreachable on social media because they are driving.[28] There are other issues businesses face with regard to public health, including labeling products that contain genetically modified organisms (GMOs), making questionable claims about the health benefits of supplements and ingredients, where and how to provide affordable housing for the homeless, and many more.

✓ Concept Check

- Describe the six basic rights of consumers.
- What are the major forces in consumerism today?
- What are some of the federal laws enacted in the last 60 years to protect your rights as a consumer?
- What are some of the issues businesses must consider with regard to public health?

2-7 Responsibilities to Employees

Learning Objective

2-7 Analyze how present employment practices are being used to counteract past abuses.

Everyone should have the opportunity to land a job for which they are qualified and to be rewarded on the basis of ability and performance. This is a fundamental issue for Americans, and it also makes good business sense. Yet, over the years, this opportunity has been denied to members of various racial, religious, political, national, and other underrepresented groups, and members of these groups are often singled out for unfavorable treatment in the workplace.

The federal government responded to the outcry of minority groups during the 1960s and 1970s by passing a number of laws forbidding discrimination in the workplace. (These laws are discussed in Chapter 9 in the context of human resources management.) Yet, more than 50 years after passage of the Civil Rights Act of 1964, abuses still exist. An example is the disparity in income levels for Whites, Blacks, Hispanics, and Asians, as illustrated in Figure 2-3. Lower incomes and higher unemployment rates also characterize Native Americans, people with disabilities, and women. Responsible managers have instituted a number of programs to counteract the results of discrimination.

2-7a Affirmative Action Programs

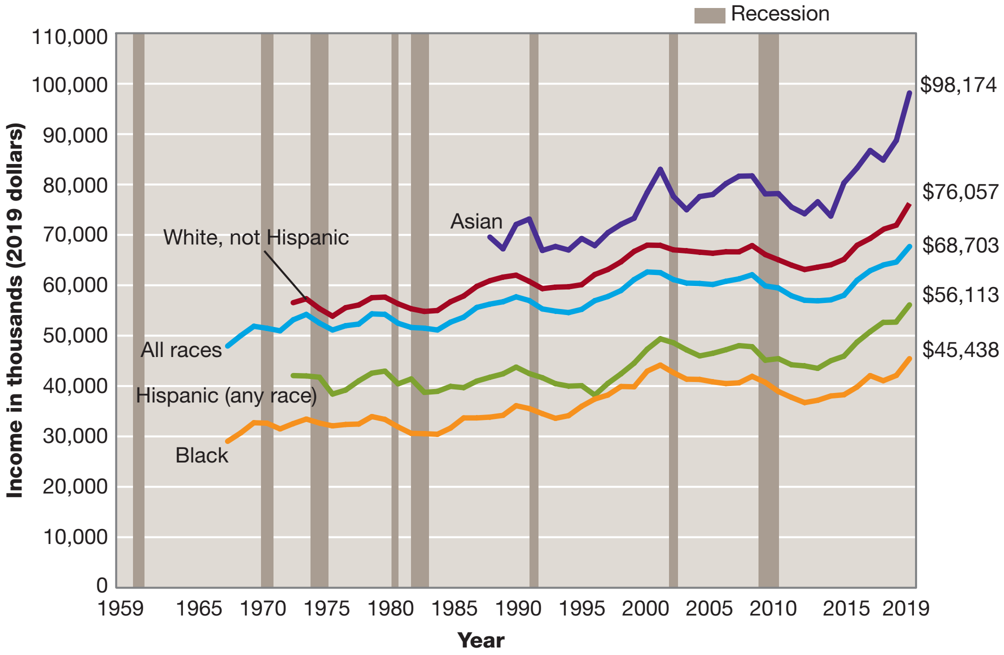
An **affirmative action program** is a plan designed to increase the number of employees from underrepresented groups at all levels within an organization. Employers with federal contracts of more than $50,000 per year must have written affirmative action plans. The objective of such programs is to ensure that members of underrepresented groups are represented within the organization in approximately the same proportion as in the surrounding community. If 25 percent of the electricians in a geographic area in which a company is located are Black, then approximately 25 percent of the electricians it employs also should be Black. Affirmative action plans encompass all areas of human resources management: recruiting, hiring, training, promotion, and pay.

affirmative action program a plan designed to increase the number of employees from underrepresented groups at all levels within an organization

Unfortunately, affirmative action programs have been plagued by two problems. The first involves quotas. In the beginning, many firms pledged to recruit and hire a

Figure 2-3 Comparative Income Levels

Real Median Household Income by Race and Hispanic Origin: 1967 to 2019



Note: The data for 2017 and beyond reflect the implementation of an updated processing system. The data for 2013 and beyond reflect the implementation of the redesigned income questions. The data points are placed at the midpoints of the respective years. Median household income data are not available prior to 1967.

Source: U.S. Census Bureau, Current Population Survey, 1968 to 2020 Annual Social and Economic Supplements, https://www.census.gov/content/dam/Census/library/visualizations/2020/demo/p60-270/figure2.pdf (accessed January 21, 2021).

certain number of people from underrepresented groups by a specific date. To achieve this goal, they were forced to consider only applicants from underrepresented groups for job openings; if they hired nonminority workers, they would be defeating their own purpose. However, the courts have ruled that such quotas are unconstitutional even though their purpose is commendable. They are, in fact, a form of discrimination called *reverse discrimination*.

Equal Employment Opportunity Commission (EEOC) a government agency with the power to investigate complaints of employment discrimination and the power to sue firms that practice it

The second problem is that although most such programs have been reasonably successful, not all businesspeople are in favor of affirmative action programs. Managers not committed to these programs can "play the game" and still discriminate against workers. To help solve this problem, Congress created (and later strengthened) the **Equal Employment Opportunity Commission (EEOC)**, a government agency with the power to investigate complaints of employment discrimination and sue firms that practice it.

FIZKES/SHUTTERSTOCK.COM

Workplace diversity A company with a diverse workforce benefits in a number of ways.

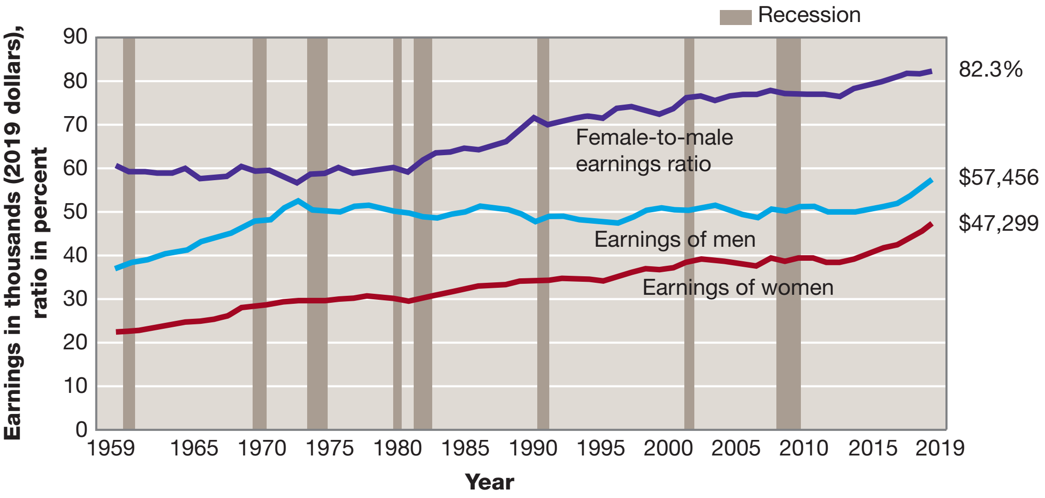
The threat of legal action has persuaded some corporations to amend their hiring and promotional policies, but the discrepancy between men's and women's salaries still exists, as illustrated in Figure 2-4. For more than 60 years, women have consistently earned only about 80 cents for each dollar earned by men.

2-7b Training Programs for the Hard-Core Unemployed

For some firms, social responsibility extends far beyond placing a help-wanted advertisement in the local newspaper. These firms have assumed the task of helping

Figure 2-4 Relative Earning of Male and Female Workers

The ratio of women's to men's annual full-time earnings was 80% in 2019, up from 74% first reached in 1996.



Note: The data for 2017 and beyond reflect the implementation of the redesigned income questions. The data for 2013 and beyond reflect the implementation of the redesigned income questions. The data points are placed at the midpoints of the respective years. Data on earnings of full-time, year-round workers are not readily available before 1960. Data are for people aged 14 and older for years prior to 1980.

Source: U.S. Census Bureau, Current Population Survey, 1961 to 2020 Annual Social and Economic Supplements, https://www.census.gov/content/dam/Census/library/visualizations/2020/demo/p60-270/figure5.pdf (accessed January 21, 2021).

the **hard-core unemployed**, workers with little education or vocational training and a long history of unemployment. These individuals may not have gained employable skills and education due to disabilities, systemic racism, economic factors, or personal issues. For example, Midas Hospitality, a hotel development and management firm, teamed up with the Boone Center, Inc., a vocational training facility for adults with intellectual and developmental disabilities, to create a program to prepare students for hotel housekeeping jobs in the St. Louis area.[29] In the past, such workers often were turned down routinely by personnel managers, even for the most menial jobs.

2-7c Programs to Reduce Sexual Harassment and Abusive Behavior

Another hot button issue in the workplace is addressing sexual harassment, bullying, and other abusive behaviors. The Workplace Bullying Institute (WBI) defines bullying in the workplace as repeated work sabotage; verbal abuse; and/or abusive conduct that is threatening, humiliating, or intimidating. The stress of bullying can result in physical and mental health issues that can ultimately cost employers many hours of lost worker productivity as well as lower morale and higher turnover. The WBI has found that 19 percent of respondents to a survey have suffered abusive conduct at work; 19 percent say they have witnessed it in the workplace.[30] Other researchers have found much higher rates of bullying. Moreover, research by the WBI suggests that half of victims do not report their bullying out of fear of further harassment because their bully is in a position of power.[31] Even football players can be subject to bullying in the workplace: Former Miami Dolphins tackle Jonathan Martin left the team because he felt he could not continue to do his job in the face of repeated bullying from other teammates.[32]

When bullying takes on sexual overtones, it becomes sexual harassment, which the U.S. Equal Employment Opportunity Commission defines as unwelcome sexual advances, requests for sexual favors, and other verbal or physical harassment of a physical nature. Unlike bullying, sexual harassment is illegal.[33] It can also result in poor morale, high turnover, and expensive lawsuits. For example, two women filed

hard-core unemployed workers with little education or vocational training and a long history of unemployment a $500 million class-action lawsuit against McDonald's, claiming that the sexual harassment they endured at corporate-owned restaurants in Florida created a "hostile work environment" for all women working in those stores. In addition to those charges, the women claimed the company did not act to stop the harassment when they reported it, and that they endured retaliation after their complaints.[34] With the #MeToo movement heightening awareness of sexual harassment in the workplace, it's no surprise that employers paid a record $68 million to survivors of workplace sexual harassment in 2019 through the Equal Employment Opportunity Commission.[35]

To create a workplace environment that stifles bullying, sexual harassment, and other abusive conduct, managers need to provide programs, much like the ones that are used to foster more ethical conduct in the workplace. In addition to creating formal policies that define and prohibit unacceptable abusive conduct, companies should strive to create an antibullying organizational culture by modeling good behavior and sending a strong message that improper conduct will be punished. Companies may even want to go a step further and offer training and additional services through employee assistance programs such as counseling to ensure that all employees feel supported.[36]

✓ Concept Check

- What is an affirmative action program? What is its purpose?
- Why did Congress create (and later strengthen) the Equal Employment Opportunity Commission?
- How can businesses reduce sexual harassment and abusive behavior at the workplace?

2-8 Responsibilities to the Environment

Learning Objective

2-8 Describe the major environmental issues and businesses' response to them.

According to a report published by the U.S. Sentencing Commission, the most common federal offense committed by organizations is not fraud or money laundering but environmental crime. Environmental offenses made up nearly a third of all crimes committed by organizations, followed by fraud at 21 percent and food/drug crimes at 12.2 percent. Seventy percent of the environmental crimes were water-related, 16.7 percent affected wildlife, 8.3 percent involved hazardous materials, and 5 percent were air-related.[37]

A growing social consciousness by the public and some business managers, fostered by government legislation, has led to major efforts to reduce environmental pollution, conserve natural resources, and reverse some of the worst damage caused by past negligence in this area.

2-8a Environmental Issues

A significant environmental issue is the amount of waste produced by businesses and society. For example, by some estimates, the United States throws out one-third of all the food produced, and grocery stores are responsible for as much as 10 percent of that. One reason for the large amount of grocery waste is consumer expectations: Consumers bypass fruits and vegetables that do not appear to be perfect, so supermarkets discard any produce that doesn't meet that expectation, even when that produce is otherwise safe and healthy.[38] The disposal problem has grown over the past few years because modern technology has continued to produce increasing amounts of chemical and radioactive waste. U.S. manufacturers produce an estimated 40 to 60 million tons of contaminated oil, solvents, acids, and sludge each year. Service businesses, utility companies, hospitals, and other industries also dump vast amounts of wastes into the environment. While companies today strive to reduce waste from operations as much as possible, much still winds up in landfills. A shortage of landfills, owing to stricter regulations, makes garbage disposal a serious problem in some areas. Incinerators help to solve the landfill-shortage problem, but they bring with them their own problems. They reduce the amount of garbage and also leave tons of ash to be buried—ash that often has a higher concentration of toxicity than the original garbage. Increasingly, plastic waste winds up in the ocean, where it accumulates into huge "garbage patches" or breaks down into microplastics that harm marine life.

Another major environmental issue is **pollution**, the contamination of water, air, or land through the actions of people in an industrialized society. Pollution harms water and air quality, threatens human and animal health, degrades habitats, and contributes to climate change. Among the serious threats to people posed by pollutants are respiratory irritation, asthma, cancer, kidney and liver damage, anemia, and heart failure. Businesspeople harm the environment when they unwittingly—or knowingly—dump hazardous chemicals and waste in unapproved ways. For example, Bernhard Schulte Shipmanagement was fined $1.75 million for improperly discharging a ship's bilge waste water into Hawaiian waters and failing to log the discharge as required by law. The Singapore-based company must also implement an environmental compliance plan for all of its vessels operating in U.S. waters.[39] For decades, environmentalists have been warning us about the dangers of industrial pollution. Unfortunately, business and government leaders either ignored the problem or were not concerned about it until pollution became a threat to life and health in America.

2-8b Effects of Environmental Legislation

As in other areas of concern to our society, legislation and regulations play a crucial role in pollution control. The laws outlined in Table 2-5 reflect the scope of current environmental legislation: laws to promote clean air, clean water, and even quiet work and living environments. Of major importance was the creation of the Environmental Protection Agency (EPA), the federal agency charged with enforcing laws designed to protect the environment.

pollution the contamination of water, air, or land through the actions of people in an industrialized society

Table 2-5 Summary of Major Environmental Laws

Legislation	Major Provisions
National Environmental Policy Act (1970)	Established the Environmental Protection Agency (EPA) to enforce federal laws that involve the environment
Clean Air Act Amendment (1970)	Provided stringent automotive, aircraft, and factory emission standards
Water Quality Improvement Act (1970)	Strengthened existing water pollution regulations and provided for large monetary fines against violators
Resource Recovery Act (1970)	Enlarged the solid-waste disposal program and provided for enforcement by the EPA
Water Pollution Control Act Amendment (1972)	Established standards for cleaning navigable streams and lakes and eliminating all harmful waste disposal by 1985
Noise Control Act (1972)	Established standards for major sources of noise and required the EPA to advise the Federal Aviation Administration on standards for airplanes
Clean Air Act Amendment (1977)	Established new deadlines for cleaning up polluted areas; also required review of existing air quality standards
Resource Conservation and Recovery Act (1984)	Amended the original 1976 act and required federal regulation of potentially dangerous solid-waste disposal
Clean Air Act Amendment (1987)	Established a national air quality standard for ozone
Oil Pollution Act (1990)	Expanded the nation's oil spill prevention and response activities; also established the Oil Spill Liability Trust Fund
Clean Air Act Amendments (1990)	Required that motor vehicles be equipped with onboard systems to control about 90% of refueling vapors
Food Quality Protection Act (1996)	Amended the Federal Insecticide, Fungicide and Rodenticide Act and the Federal Food Drug and Cosmetic Act; the requirements included a new safety standard—reasonable certainty of no harm—that must be applied to all pesticides used on foods
American Recovery and Reinvestment Act (2009)	Provided $7.22 billion to the EPA to protect and promote "green" jobs and a healthier environment

MIKE SHOOTER/SHUTTERSTOCK.COM

Pollution Oil spills can have long-lasting effects on our wildlife and other natural resources. As our population and businesses expand, the need to reduce pollution at its source becomes more important.

When they are aware of a pollution problem, many firms are proactive in addressing it rather than wait to be cited by the EPA. Other owners and managers, however, take the position that environmental standards are too strict. (Loosely translated, this means that compliance with present standards is too expensive.) Consequently, it often has been necessary for the EPA to take legal action to force firms to install antipollution equipment and to clean up waste storage areas. Americold Logistics, for example, was fined $41,500 for illegally leaking pollutants into a creek and violating its Washington state industrial stormwater permit, among other EPA charges. The company, which promptly acknowledged and acted to resolve the issues, agreed to develop and implement plans to reduce pollutants leaving its food warehouse facility.[40]

Experience has shown that the combination of environmental legislation, voluntary compliance, and EPA action can succeed in restoring the environment and keeping it clean. However, much still remains to be done.

2-8c Business Response to Environmental Concerns

recycling converting used materials into new products or components for new products in order to prevent their unnecessary disposal

One of the most effective ways that companies can reduce their impact on the environment is to reduce waste from operations and other activities. Identifying and eliminating inefficiencies in production and operations is where most firms begin that process. Finding alternative uses for waste is another. For example, leftover food from supermarkets and restaurants is often donated to local food banks or sold to farmers who feed it to livestock. Most companies strive to recycle as much as possible. **Recycling** involves converting used materials into new products or components for new products in order to prevent their unnecessary disposal. Companies can recycle waste paper, glass, rubber, metals, some plastic packaging, and other materials so that they or their components can be reprocessed into new products and kept out of landfills. As an example, Madewell gives customers $20 toward a new pair of Madewell jeans when they bring in worn-out or out-of-style jeans of any brand. The clothing company donates the used denim to the Cotton's Blue Jeans Go Green program, which turns it into insulation for homes, preventing 529 tons of waste from going into a landfill thus far.[41]

Another way businesses strive to be more environmentally conscious is through the use of "greener" forms of power to counter their use of huge quantities of energy during operations and other activities. Companies can audit their operations to identify places where more efficient and environmentally friendly products can be used to save energy, such as using LED light bulbs—which reduce heat as well as power use—and even natural sunlight to light workplaces. Many companies are turning to alternative forms of power generation,

SPACE-KRAFT/SHUTTERSTOCK.COM

Reducing dependence on fossil fuels Today's businesses (and consumers) are more open to alternative sources of energy because they are concerned about the negative impact of conventional energy sources.

Sustaining the Planet

Is Sustainability Profitable?

Sustainability has taken the spotlight as environmental consciousness grows among consumers, business professionals, and investors. Though sustainability was once an afterthought for many organizations, more than ever shoppers are looking for products and brands that align with their values. Long story short: sustainability leads to profitability.

In the not-too-distant past, it was difficult to convince investors that sustainability and profitability were linked. Now, with many companies aligning executive bonuses with sustainability targets, there's a growing consensus that environmental, social, and governance practices are strategic priorities. This shift has caused businesses to evaluate their supply chains, from materials to transportation, to find opportunities to limit their environmental impact. Environmental goals often include water reduction, zero waste to landfill, and lowering carbon energy use. Additionally, companies can focus on making products more durable, reusable, repairable, and recyclable.

Investors, who now see that the future is green, often have specific environmental expectations and put pressure on companies to evolve. Many organizations have reaped the benefits of leading with sustainability. According to *The Wall Street Journal*, the most sustainably managed companies in the world include Sony (hardware), Philips (medical equipment), Cisco Systems (hardware), Merck (biotechnology and pharmaceuticals), and Iberdrola (electric utilities and power generators). These organizations have all prioritized environmental concerns while maintaining high profits, showing that sustainability can play a critical role in an organization's future success.

Sources: Based on information in Dieter Holger and Olivia Bugault, "CEOs Increasingly See Sustainability as Path to Profitability," *The Wall Street Journal*, October 12, 2020, www.wsj.com/articles/ceos-increasingly-see-sustainability-as-path-to-profitability-11602535250; Fabiana Negrin Ochoa, Dieter Holger, Maitane Sardon, and Catherine Lindsay, "The 100 Most Sustainably Managed Companies in the World," *The Wall Street Journal*, October 13, 2020, www.wsj.com/articles/the-100-most-sustainably-managed-companies-in-the-world-11602507298.

including solar and wind power which do not rely on diminishing sources of fossil fuels. New Belgium Brewing in Fort Collins, Colorado, became the first company to be 100 percent powered by the wind, but many other companies have followed suit. A number of Fortune 500 businesses, including Google, Apple, Starbucks, Cisco, and Bank of America, get 100 percent of their electricity from renewable energy sources such as wind and solar.[42]

Recognizing public demand for greater environmental responsibility, more and more firms are adopting environmentally friendly practices and products that are less harmful to the environment. **Green marketing** is the process of creating, making, delivering, and promoting products that are environmentally safe. It may include making modifications to products, manufacturing processes, packaging, and/or promotion activities to make or deliver products that are better for the environment. Chipotle Mexican Grill, for example, built its reputation as a green marketer by abiding by its "Cultivate a Better World" mission, which requires using real ingredients that "are responsibly sourced and classically cooked with people, animals and the environment in mind." To live by that mission, the company strives to use only natural animal products (treated humanely and fed a vegetarian diet that does not include growth hormones or antibiotics), organic ingredients, and where possible, local sources. It also educates consumers and other stakeholders about its efforts through a Real Foodprint tracker on its app as well as a regularly released Sustainability Report that details its sustainability goals and progress in reaching them. It is significant that Chipotle has not yet achieved all its sustainability goals, but its mission guides the firm in all decision making and activities.[43]

Recognizing that consumers increasingly prefer to purchase from businesses that make recycling, green energy, and sustainability a strategic priority, companies are increasingly touting their green efforts. However, green marketers must take care to ensure that their claims are backed by evidence that shows a significant

green marketing the process of creating, making, delivering, and promoting products that are environmentally safe environmental benefit and does not mislead consumers or they may run afoul of the Federal Trade Commission.[44] Companies that take their green marketing efforts too far, without relevance or support for their environmental claims risk being labeled guilty of *green washing*.

As we have seen, more businesses are trying harder to make their activities and products sustainable going forward, but what about cleaning up past environmental messes—oil spills, improperly stored industrial wastes, polluting emissions, and more—that harm the environment today? Many business leaders offer one answer: Use tax money to clean up the environment and to keep it clean. They reason that business is not the only source of pollution, so business should not be forced to absorb the entire cost of the cleanup. Environmentalists disagree. They believe that the cost of proper treatment and disposal of industrial wastes is an expense of doing business. In either case, consumers ultimately will bear a large part of the cost—either as taxes or in the form of higher prices for goods and services.

✓ Concept Check

- What are the major environmental issues facing society today?
- Summarize major provisions of federal environmental laws enacted since 1970.
- What is businesses' response to environmental concerns?

2-9 Implementing a Program of Social Responsibility

Learning Objective

2-9 Identify the steps a business must take to implement a program of social responsibility

A firm's decision to be socially responsible is a step in the right direction—but only the first step. The business then must develop and implement a program to reach this goal. The program will be affected by the firm's size, financial resources, past record in the area of social responsibility, and competition. Above all, however, the program must have the firm's total commitment or it will fail.

An effective program for ethics and social responsibility requires time, money, and organization. In most cases, developing and implementing such a program will require four steps: securing the commitment of top executives, planning, appointing a director, and preparing a social audit.

2-9a Commitment of Top Executives

Without the support of top executives, any program will soon falter and become ineffective. At CitiGroup, the board of directors maintains the Ethics, Conduct, and Culture Committee, which oversees the financial conglomerate's ethics and compliance program.[45] As evidence of their commitment to social responsibility, top managers should develop a policy statement that outlines key areas of concern. Such statements set a tone of positive support and later will serve as a guide for other employees as they become involved in the program.

2-9b Planning

Next, a committee of managers should be appointed to plan the program. Whatever form their plan takes, it should deal with each of the issues described in the top managers' policy statement. If necessary, outside consultants can be hired to help develop the plan.

2-9c Appointment of a Director

After the social responsibility plan is established, a top-level executive should be appointed to implement the organization's plan. This individual should be charged with recommending specific policies and helping individual departments to understand and live up to the social responsibilities the firm has assumed. Depending on the size of the firm, the director may require a staff to handle the program on a day-to-day basis. For example, at Cisco, Tae Yoo, Senior Vice President of Corporate Affairs, administers the technology giant's corporate social responsibility program, including applying its resources to facilitate problem solving that has positive impacts on people, society, and the Earth.[46]

2-9d **The Social Audit**

At specified intervals, the program director should prepare a social audit for the firm. A **social audit** is a comprehensive report of what an organization has done and is doing with regard to social issues that affect it. This document provides the information the firm needs to evaluate and revise its social responsibility program. Typical subject areas include human resources, community involvement, the quality and safety of products, business practices, and efforts to reduce pollution and improve the environment. The information included in a social audit should be as accurate and as quantitative as possible, and the audit should reveal both positive and negative aspects of the program. Caesars Entertainment, which operates casinos, evaluates its corporate citizenship efforts annually and then issues a report describing its performance for a variety of stakeholders including employees, investors, and the media. Caesars' Corporate Citizenship Report details its performance in meeting goals in the areas of responsible gaming, employee development, environmental stewardship, and community investment.[47]

Today, many companies listen to concerned individuals within and outside the company. For example, the Citi Ethics Line listens to and acts on concerns expressed by employees and others about possible violations of company policies, laws, or regulations, such as improper or unethical business practices, as well as health, safety, and environmental issues. Employees are encouraged to communicate their concerns, as well as ask questions about ethical issues. The Ethics Line is available to all Citi employees, as well as concerned individuals outside the company.

social audit a comprehensive report of what an organization has done and is doing with regard to social issues that affect it

✓ Concept Check

- What steps must a business take to implement a program of social responsibility?
- What is the social audit? Who should prepare a social audit for the firm?

Summary

2-1 Define *business ethics.*

Ethics is the study of right and wrong and of the morality of choices. Business ethics is the application of moral standards to business situations.

2-2 Identify the types of ethical concerns that arise in the business world.

Ethical issues arise often in business situations out of relationships with investors, customers, employees, creditors, or competitors. Businesspeople should make every effort to be fair, to consider the welfare of customers and others within the firm, to avoid conflicts of interest, and to communicate honestly.

2-3 Discuss the factors that affect the level of ethical behavior in organizations.

Individual, social, and opportunity factors all affect the level of ethical behavior in an organization. Individual factors include knowledge level, moral values and attitudes, and personal goals. Social factors include cultural norms and the actions and values of co-workers and significant others. Opportunity factors refer to the amount of leeway that exists in an organization for employees to behave unethically if they choose to do so.

2-4 Explain how organizations can encourage ethical decision making in business.

Governments, trade associations, and individual firms can establish regulations and guidelines for defining ethical behavior. Governments can pass stricter regulations and laws. Trade associations provide ethical guidelines for their members. Companies provide and enforce codes of ethics—written guides to acceptable and ethical behavior as defined by an organization—and create an atmosphere in which ethical behavior is encouraged. An ethical employee working in an unethical environment may resort to whistle-blowing to bring a questionable practice to light.

2-5 Describe how our current views on the social responsibility of business have evolved.

In a socially responsible business, management realizes that its activities have an impact on society and considers that impact in the decision-making process. Before the 1930s, workers, consumers, and government had very little influence on business activities; as a result, business leaders gave little thought to social responsibility. All this changed with the Great Depression. Government regulations, employee demands, and consumer awareness combined to create a demand that businesses act in socially responsible ways.

The basic premise of the economic model of social responsibility is that society benefits most when business is left alone to produce profitable goods and services. According to the socioeconomic model, business has as much responsibility to society as it has to its owners. Most managers adopt a viewpoint somewhere between these two extremes.

2-6 List the responsibilities businesses have to the public, especially with regard to consumer rights and public health.

Consumerism consists of all activities undertaken to protect the rights of consumers. Although concerns over consumer rights have been around to some extent since the early 19th century, the movement became more powerful in the 1960s when President John F. Kennedy initiated the Consumer Bill of Rights. The six basic rights of consumers include the right to safety, the right to be informed, the right to choose, the right to be heard, and the rights to consumer education and courteous service. Today, many people believe that businesses have a basic responsibility to contribute to the general wellbeing of the public. Other issues businesses face relate to public health, including addressing products that contribute to obesity and cancer.

2-7 Analyze how present employment practices are being used to counteract past abuses.

Legislation and public demand have prompted some businesses to correct past abuses in employment practices—mainly with regard to minority groups. Affirmative action and training of the hard-core unemployed are two types of programs that have been used successfully. Another issue in the workplace is addressing sexual harassment and other abusive behaviors, such as bullying and verbal abuse.

2-8 Describe the major environmental issues and businesses' response to them.

A growing social consciousness, fostered by government legislation, has led to major efforts to reduce waste and pollution, conserve natural resources, and reverse some of the worst damage caused by past negligence in this area. Current environmental laws, enforced by the Environmental Protection Agency, promote clean air, clean water, and even quiet work and living environments. However, much still remains to be done. Many companies are looking for ways to reduce their environmental footprint, such as improving operations to reduce waste, recycling, using alternative forms of energy, including solar and wind power, and engaging in green marketing—the process of creating, making, delivering, and promoting products that are environmentally safe.

2-9 Identify the steps a business must take to implement a program of social responsibility.

A program to implement social responsibility in a business begins with total commitment by top management. The program should be planned carefully, and a capable director should be appointed to implement it. Social audits should be prepared periodically as a means of evaluating and revising the program.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

ethics (38)
business ethics (38)
plagiarism (40)
conflict of interest (40)
Sarbanes-Oxley Act of 2002 (43)
code of ethics (44)
whistle-blowing (45)
social responsibility (47)
corporate citizenship (48)
caveat emptor (48)
economic model of social responsibility (49)
socioeconomic model of social responsibility (49)
consumerism (51)
affirmative action program (55)
Equal Employment Opportunity Commission (EEOC) (56)
hard-core unemployed (57)
pollution (59)
recycling (60)
green marketing (61)
social audit (63)

Discussion Questions

1. When a company acts in an ethically questionable manner, what types of problems are caused for the organization and its customers?
2. What factors affect ethical behavior and choices? How can businesses use this knowledge to further ethical behavior in their organizations?
3. How can employees take an ethical stand regarding a business decision when their superior already has taken a different position?
4. How can businesses encourage employees to make ethical choices?
5. Overall, would it be more profitable for a business to follow the economic model or the socioeconomic model of social responsibility?
6. Why should business take on the task of training the hard-core unemployed?
7. To what extent should the blame for vehicular air pollution be shared by manufacturers, consumers, and government?
8. Why is there so much government regulation involving social responsibility issues? Should there be less?

Case 2

Inside Whole Trade at Whole Foods

Whole Foods Market, a natural supermarket chain, was founded in Austin, Texas, in 1980. At the time, the market for natural, unprocessed foods was small, but the company soon expanded to new cities as demand grew. Now, the grocer can be found in 500 locations across North America and the United Kingdom. Since the beginning, responsible sourcing has been a core component of Whole Foods' business. This stakeholder orientation focuses on the needs of its customers, its employees, its communities, and people at every level of its supply chain.

The Whole Trade Guarantee is Whole Foods' ethical trading program. It supports ethical trade, proper working conditions, and environmental protection in the production of the products it sells. Products with this label meet rigorous quality standards and come from certified farms that have a history of positive impacts on their employees, supply chain partners, communities, and the environment. Through the program, Whole Foods provides funds to the farms they work with to support various community initiatives such as community centers, medical services, and dental care. Programs such as Whole Trade support Whole Foods' mission to nourish both people and the planet.

Whole Foods has often been called "Whole Paycheck" because of the more expensive price tags on its products. However, Whole Foods believes that, as a responsible buyer, it has a duty to monitor its impact on the environment and individuals throughout the supply chain. Pressure from retailers to lower costs can lead to farm owners exploiting workers to deliver products cheaply. One of Whole Foods' goals is to provide its shoppers with affordable, sustainable food that also supports farmers and farmworkers.

Beyond creating win–win partnerships with its suppliers, Whole Foods ultimately views customers as its most important stakeholder. To differentiate itself from its competitors, Whole Foods emphasizes the quality of its products over price. The company has a variety of quality standards to ensure its customers get the best, including standards for its meat, eggs, seafood, supplements, beauty products, and household cleaners. In addition, Whole Foods bans more than 100 ingredients such as high-fructose corn syrup.

Employees at Whole Foods are another top priority. Full-time team members are offered comprehensive health insurance. The company also provides its team members with career and learning development, volunteer programs through the Whole Planet Foundation, and team member assistance plans. In addition to competitive pay, the company also offers 401(k) plans and health savings accounts, discounts, and paid time off.

All of these efforts combined help Whole Foods earn profits, which in turn creates value for its shareholders. Profits are essential for any business to survive, and Whole Foods believes it has a responsibility to its parent company, Amazon, to use its capital in the best way possible to achieve the best results possible. Not everyone was pleased when Amazon acquired Whole Foods in 2017 for $13.4 billion. Many employees noticed a change in working conditions such as heavier workloads and budget cuts. Amazon also sought to make Whole Foods' products more affordable by purchasing a greater number of products from national food distributors rather than local farms. Prices have since returned to pre-Amazon levels but other initiatives—such as discounts for Amazon Prime members—remain to provide customers with more value.

Whole Food's strong relationships with its supply chain partners are fostered by its Whole Trade program. This is a core strength that can be leveraged by both Whole Foods and Amazon to stand out. Though many criticized Amazon's acquisition of Whole Foods due to their cultural differences, Amazon's deep pockets and robust supply chain knowledge will surely benefit Whole Foods in the long run. By committing to ethical and sustainable trading practices, Whole Foods sets itself apart from traditional supermarkets.[48]

Questions

1. Why do you think Whole Foods wants to support the farmers and farmworkers in its supply chain?
2. Why are customers willing to pay a premium for goods at Whole Foods?
3. How does Whole Foods meet the needs of its customers?

Building Skills for Career Success

1. Social Media Exercise

Lego has been making children's toys since the 1930s and its iconic plastic building blocks since 1958. Company executives, wanting their products to have a lasting legacy, have launched several initiatives to leave the world a better place. Visit Lego's website to learn more about these initiatives (https://www.lego.com/en-us/aboutus/sustainability/environment/) and search for Lego on YouTube.

1. What responsibilities do you think Lego has to its customers—the children as well as their parents?

2. Are these initiatives consistent with the firm's mission and values (https://www.lego.com/en-us/lego-history)? Why or why not?
3. Search YouTube and then describe how Lego's sustainability efforts compare with those of rivals like Mattel and Hasbro.

2. Building Team Skills

A firm's code of ethics outlines the kinds of behaviors expected within the organization and serves as a guideline for encouraging ethical behavior in the workplace. It reflects the rights of the firm's workers, shareholders, and consumers.

Assignment

1. Working in a team of four, find a code of ethics for a business firm. Start the search by asking firms in your community for a copy of their codes, by visiting the library, or by searching and downloading information from the internet.
2. Analyze the code of ethics you have chosen, and answer the following questions:
    a. What does the company's code of ethics say about the rights of its workers, shareholders, consumers, and suppliers? How does the code reflect the company's attitude toward competitors?
    b. How does this code of ethics resemble the information discussed in this chapter? How does it differ?
    c. As an employee of this company, how would you personally interpret the code of ethics? How might the code influence your behavior within the workplace? Give several examples.

3. Researching Different Careers

Business ethics has been at the heart of many discussions over the years and continues to trouble employees and shareholders. Stories about dishonesty and wrongful behavior in the workplace appear on a regular basis in newspapers and on the national news.

Assignment

Prepare a written report on the following:

1. Why can it be so difficult for people to do what is right?
2. What is your personal code of ethics? Prepare a code outlining what you believe is morally right. The document should include guidelines for your personal behavior.
3. How will your code of ethics affect your decisions about:
    a. The types of questions you should ask in a job interview?
    b. Selecting a company in which to work?

Chapter

3

METAMORWORKS/SHUTTERSTOCK.COM

Global Business

Learning Objectives

Once you complete this chapter, you will be able to:

3-1 Explain the economic bases for and importance of international business.

3-2 Explore the methods by which a firm can organize for and enter into international markets.

3-3 Discuss the challenges businesses face when entering international markets, especially the restrictions nations place on international trade.

3-4 Identify the facilitators of international trade, including international trade agreements and international economic organizations working to foster trade.

3-5 Describe sources of export assistance.

3-6 Identify institutions that can help businesses and nations finance international business.

Why Should You Care?

Free trade—are you for or against it? Most economists support free-trade policies, but public support can be lukewarm, and certain groups are adamantly opposed, contending that "trade harms large segments of U.S. workers," "degrades the environment," and "exploits the poor."

Inside Business

Starbucks Goes Global for Growth

Starbucks, the world's largest coffeehouse chain, has more stores internationally than it does in the United States as a result of putting global expansion at the center of its growth strategy. Domestically, Starbucks has slowed new store openings and closed locations deemed redundant in dense metro areas in order to put the company in a more profitable position. While Starbucks tackles changing consumer behavior in the United States, other countries present valuable growth opportunities.

An aggressive push into China, Starbucks' fastest-growing market, has been successful for the company. According to Starbucks China CEO and chairperson Belinda Wong, at one point in time, Starbucks opened a new store in China every 15 hours. The company announced plans to invest $150 million in a roasting plant in China, deepening its commitment to building the Starbucks brand throughout Asia. The company's only other non-U.S. roasting facility is in Amsterdam to support Europe.

To penetrate China's coffee market, the coffeehouse chain focused on rolling out innovation even faster than in the United States. For example, to appeal to local tastes, the menu in China includes a variety of tea-based beverages as well as exclusive drink categories. Additionally, Starbucks rolled out delivery in Beijing and Shanghai and 11 other cities in China before it expanded delivery in the United States. The Asia-Pacific market accounts for approximately half of Starbucks' global new store growth.[1]

Did you know?

Starbucks has 32,000 stores across more than 80 markets.

Like Starbucks, many companies, large and small, do business around the world. Did you know that only 31 percent of the Coca-Cola Company's sales come from North America? Asia-Pacific and Latin American markets generate 14 percent and 11 percent, respectively, of the revenues of the beverage giant.[2] Even small businesses can find great success in global markets. One such company is Combustion Associates of Corona, California, a small business founded by husband-and-wife immigrants from Bangladesh. The company designs, manufactures, and exports large power generators to developing countries.[3] Whether they buy or sell products across national borders, these companies are all contributing to the volume of international trade that is fueling the global economy.

Theoretically, international trade is every bit as logical and worthwhile as interstate trade between, say, California and Washington. Yet, nations tend to restrict the import of certain goods for a variety of reasons. For example, the United States restricted the import of Mexican fresh tomatoes because they were undercutting price levels of domestic fresh tomatoes. Despite such restrictions, international trade has increased almost steadily since World War II. Many of the industrialized nations have signed trade agreements intended to reduce problems in international business and to help less-developed nations participate in world trade. Individual firms around the world have seized the opportunity to compete in foreign markets by exporting products and increasing foreign production, as well as by other means.

In this chapter, we describe international trade in terms of modern specialization, whereby each country trades the surplus goods and services it produces most efficiently for products its citizens and organizations need. We also consider the importance and extent of international trade with the U.S. economy. Next, we explore several methods of entering international markets. We then examine the challenges business organizations face when engaging in trade across borders and identify organizations working to

Entrepreneurial Success

Alibaba Transforms China by Investing in Entrepreneurs

Alibaba, one of the world's largest e-commerce companies, invests in Hong Kong and Taiwan-based entrepreneurs through its not-for-profit arm, the Alibaba Entrepreneurs Fund. In addition to investment capital, Alibaba provides guidance to help individuals scale their businesses, making use of Alibaba's tools and resources. The Chinese e-commerce giant aims to build Hong Kong's start-up ecosystem by fueling entrepreneurship and innovation.

According to a survey conducted by Alibaba and KPMG, corporate executives benefit from collaborating with start-ups because it helps keep them up to date on the latest innovations. Entrepreneurs develop new ideas, find solutions that address society's needs, diversify the economy, and create upward mobility. Lynk, one of the businesses Alibaba has invested in, is the first-ever Software-as-a-Service platform built on an expert network. The service allows businesses to easily connect with a diverse set of 840,000 advisors rather than hiring experts in-house. The company has raised more than $30 million in capital.

By supporting the entrepreneurial landscape in China, Alibaba's marketplace and other platforms will benefit. The Alibaba Entrepreneurs Fund follows a venture capitalist model, except profits from the company's venture investments are returned to the fund for reinvestment, ensuring capital is always available. Independent professionals with start-up experience evaluate and select the entrepreneurs that will receive funding and strategic guidance from Alibaba's network of business leaders. The not-for-profit looks for innovative start-ups in the big data, cleantech, e-commerce, fintech, and logistics sectors, among others. Alibaba then leverages its resources to help the entrepreneurs grow their businesses.

Sources: Based on information in "Alibaba Hong Kong Entrepreneurs Fund Launches JUMPSTARTER 2021 Global Pitch Competition," *Business Wire*, July 28, 2020, www.businesswire.com/news/home/20200728005440/en/Alibaba-Hong-Kong-Entrepreneurs-Fund-Launches-JUMPSTARTER-2021-Global-Pitch-Competition; Alibaba Entrepreneurs Fund, "Transforming Hong Kong Through Entrepreneurship," https://www.ent-fund.org/en/joint-study2020; Catherine Shu, "Lynk, a 'Knowledge-as-a-Service' Platform with More Than 840,000 Experts, Raises $24 Million," *TechCrunch*, January 27, 2021, www.techcrunch.com/2021/01/27/lynk-a-knowledge-as-a-service-platform-with-more-than-840000-experts-raises-24-million.

facilitate global trade. We also outline the various sources of export assistance available from the federal government. Finally, we identify some of the institutions that provide the complex financing necessary for modern international trade.

3-1 The Basis for International Business

Learning Objective

3-1 Explain the economic bases for and importance of international business.

International business encompasses all business activities that involve exchanges across national boundaries. Thus, a firm is engaged in international business when it buys some portion of its input from, or sells some portion of its output to, an organization located in a foreign country. (A small retail store may sell goods produced in some other country. However, because it purchases these goods from American distributors, it is not engaged in international trade.)

3-1a Absolute and Comparative Advantage

Some countries are better equipped than others to produce particular goods or services. The reason may be a country's natural resources, its labor supply, or even customs or a historical accident. In such cases, it would be advantageous for a country to specialize in the production of such products so that it can produce them most efficiently. The country could use what it needed of these products and then trade the surplus for products it could not produce efficiently on its own. Saudi Arabia thus has specialized in the production of crude oil and petroleum products; South Africa, in diamonds; and Australia, in wool. Each of these countries is said to have an absolute advantage with regard to a particular product. An **absolute advantage** is the ability to produce a specific product more efficiently than any other nation.

international business all business activities that involve exchanges across national boundaries

absolute advantage the ability to produce a specific product more efficiently than any other nation

TTSTUDIO/SHUTTERSTOCK.COM

A U.S. absolute advantage. The United States has long specialized in the production of wheat. Because of its specific geography and climate, the United States enjoys an absolute advantage—the ability to produce wheat more efficiently than countries in other parts of the world.

One country may have an absolute advantage with regard to several products, whereas another country may have no absolute advantage at all. Yet it is still worthwhile for these two countries to specialize and trade with each other. To see why this is so, imagine that you are the president of a successful manufacturing firm and that you can accurately type 90 words per minute. Your assistant can type 80 words per minute but would run the business poorly. Thus, you have an absolute advantage over your assistant in both typing and managing. However, you cannot afford to type your own letters because your time is better spent in managing the business. That is, you have a comparative advantage in managing. A **comparative advantage** is the ability to produce a specific product more efficiently than any other product. Your assistant, on the other hand, has a comparative advantage in clerical duties because he or she can do that better than managing the business. Thus, you spend your time managing, and you leave the document preparation to your assistant. Overall, the business is run as efficiently as possible because you are each working in accordance with your own comparative advantage.

The same is true for nations. Goods and services are produced more efficiently when each country specializes in the products for which it has a comparative advantage. Moreover, by definition, every country has a comparative advantage in some product. The United States has many comparative advantages—in research and development, high-technology industries, and identifying new markets, for instance.

3-1b Exporting and Importing

Suppose that the United States specializes in producing corn. It then will produce a surplus of corn, but perhaps it will have a shortage of wine. France, on the other hand, specializes in producing wine but experiences a shortage of corn. To satisfy both needs—for corn and for wine—the two countries should trade with each other. The United States should export corn and import wine. France should export wine and import corn.

Exporting is selling and shipping raw materials or products to other nations. The Boeing Company, for example, exports its airplanes to a number of countries for use by their airlines. On a smaller scale, the Liriope Factory, a small Louisiana nursery, has expanded the customer base for its ground cover plants by exporting to European markets.[4] Figure 3-1 shows selected top merchandise-exporting states in the United States.

Importing is purchasing raw materials or products in other nations and bringing them into one's own country. Thus, buyers for Macy's department stores may purchase rugs in India or raincoats in England and have them shipped back to the United States for resale.

3-1c Balance of Trade

Importing and exporting are the principal activities in international trade. They give rise to an important concept called the *balance of trade*. A nation's **balance of trade** is the total value of its exports minus the total value of its imports over

comparative advantage the ability to produce a specific product more efficiently than any other product

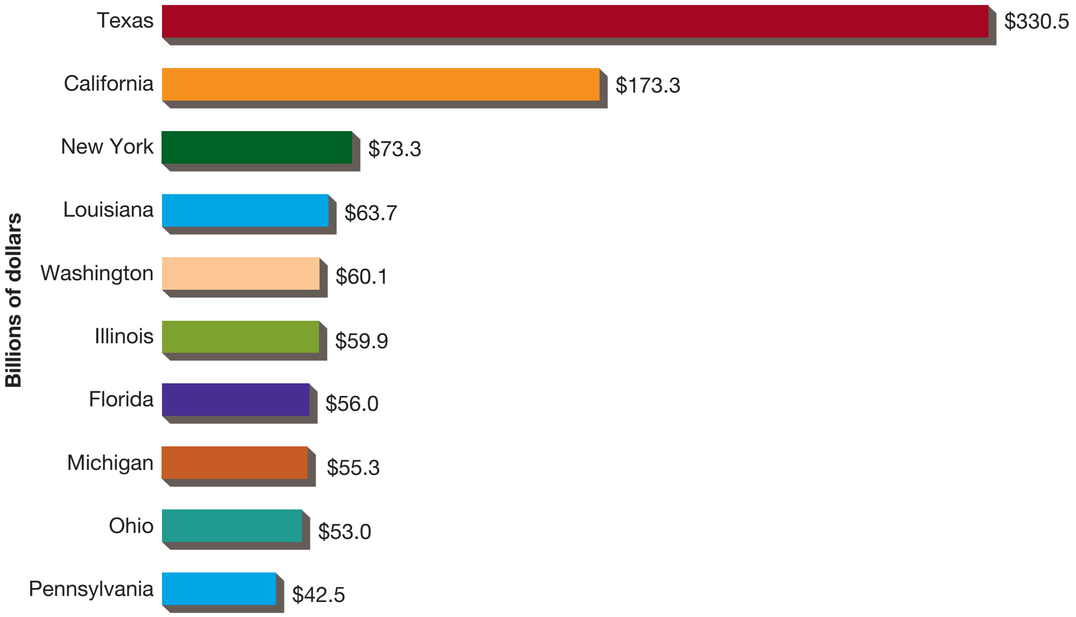
exporting selling and shipping raw materials or products to other nations

importing purchasing raw materials or products in other nations and bringing them into one's own country

balance of trade the total value of a nation's exports minus the total value of its imports over a specified period of time

Figure 3-1 Selected Top Exporting States

Texas and California account for about one-third of all U.S. exports.



Source: Daniel Workman, "America's Top 20 Export States," *World's Top Exports*, March 2020, http://www.worldstopexports.com/americas-top-20-export-states/ (accessed February 22, 2021).

a specified period of time. If a country imports more than it exports, its balance of trade is negative and is said to be *unfavorable*. On the other hand, when a country exports more than it imports, it is said to have a *favorable* balance of trade.

In 2020, the United States imported $2,810.6 billion worth of goods and services and exported $2,131.9 billion worth. It thus had a trade deficit of $678.7 billion.[5] A **trade deficit** is a negative balance of trade (refer to Figure 3-2). However, the United States has consistently enjoyed a large and rapidly growing surplus in services, such as computer and banking services. For example, in 2020, the United States imported $460.1 billion worth of services and exported $697.1 billion worth, thus creating a favorable balance of $237 billion.[6]

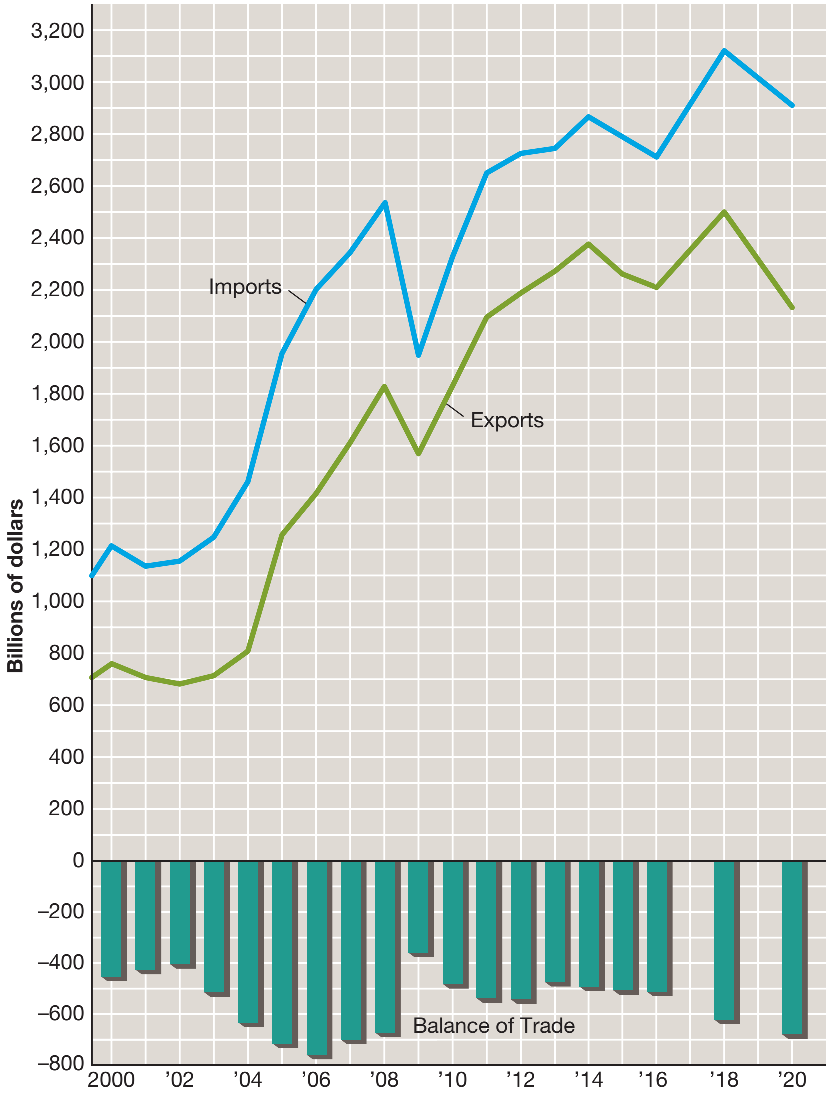
trade deficit a negative balance of trade

MICHAEL FITZSIMMONS/SHUTTERSTOCK.COM

U.S. exports. **U.S. aircraft and spacecraft products represent the third largest U.S. exports.**

Figure 3-2 U.S. International Trade in Goods and Services

If a country imports more goods than it exports, the balance of trade is negative, as it was in the United States from 2000 to 2020.



Sources: U.S. Department of Commerce, International Trade Administration, https://bea.gov/newsreleases/international/trade/2017/pdf/trade1216.pdf (accessed February 16, 2017); U.S. Bureau of Economic Analysis, "U.S. International Trade in Goods and Services, December 2020," February 5, 2021, https://www.bea.gov/news/2021/us-international-trade-goods-and-services-december-2020 (accessed February 23, 2021); U.S. Bureau of Economic Analysis, "U.S. International Trade in Goods and Services, December 2018," March 6, 2019, https://www.bea.gov/news/2019/us-international-trade-goods-and-services-december-2018 (accessed February 23, 2021).

Question: *Are trade deficits bad?*

Answer: It's complicated. A negative balance of trade is often viewed as unfavorable because the country must export money to pay for its excess imports. However, trade deficits also mean that consumers at home have the benefit of a wider variety of products at competitive prices. Consider the iPhone, which is manufactured in China. If it were to be made in the United States, it likely would retail for $2,000, but lower supply and labor costs overseas mean that Apple can sell most models for less than $1,000, or twice as many.[7] These lower prices also help stifle the threat of inflation. In the long run, though, trade deficits give rise to sending more jobs overseas where costs are often significantly lower, thereby resulting in less job creation at home. This is indeed what is happening in the United States.

A nation's **balance of payments** is the total flow of money into a country minus the total flow of money out of that country over a specified period of time. Balance of payments, therefore, is a much broader concept than balance of trade. It includes imports and exports, of course. However, it also includes investments, money spent by foreign tourists, payments by foreign governments, aid to foreign governments, and all other receipts and payments. A continual deficit in a nation's balance of payments (a negative balance) can cause other nations to lose confidence in that nation's economy. Alternatively, a persistent surplus may indicate that the country encourages exports but limits imports by imposing trade restrictions.

3-1d The Economic Outlook for Trade

International trade is a major growth vehicle for the United States. More than 40 million full- and part-time jobs, or about one out of every five jobs in the United States, depend on international trade. The percentage of American jobs tied to global trade has doubled since 1992, growing from 10.4 percent to 20.2 percent.[8] In 2018, for the first time, the U.S. exports exceeded $2.5 trillion, up from $25 billion in 1960.[9] Many other countries have experienced similar growth. This dramatic increase in trade volume over the past 60 years has been one of the most important factors in the rise of living standards around the world. During this time, exports have become increasingly important to the U.S. economy. Exports as a percentage of U.S. GDP have increased steadily since 1970, except during recessions. Table 3-1 shows U.S. exports and imports for selected world areas in 2020, and Table 3-2 shows the value of U.S. merchandise exports to, and imports from, each of the nation's ten major trading partners. Note that Canada and Mexico are our best partners for our exports; China and Mexico, for imports.

Although the worldwide recessions of 1991, 2001–2002, and 2008–2009 slowed the rate of growth, and the global COVID-19 pandemic economic crisis caused the sharpest decline in more than 75 years, globalization is a reality of our time. In the United States, international trade now accounts for over one-fourth of gross domestic product (GDP). As trade barriers decrease, new competitors enter the global marketplace, creating more choices for consumers and new opportunities for job seekers. Looking ahead, the International Monetary Fund (IMF), an international bank with 190 member nations, expected global growth to continue, albeit more slowly as world economies recover from the pandemic and social unrest. The IMF

Table 3-1 U.S. Exports and Imports of Goods for Selected World Areas in 2020 in Billions of Dollars

Selected World Area*	Exports	Imports
North America	$468	$596
Europe	$332	$577
Euro Area	$213	$368
European Union	$232	$415
Pacific Rim	$376	$825
South/Central America	$130	$91
Africa	$22	$24
OPEC	$35	$19
Other Countries	$74	$209

*Countries may be included in more than one area grouping.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, "Monthly U.S International Trade in Goods, December 2020," https://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf (accessed February 23, 2021).

balance of payments the total flow of money into a country minus the total flow of money out of that country over a specified period of time

Table 3-2 Top Trading Partners: Value of U.S. Merchandise Exports and Imports of Goods, 2020

Rank	Country	Exports ($ billions)	Imports ($ billions)	Total Trade ($ billions)	Percent of Total Trade
1	China	124.6	435.4	560.1	14.9
2	Mexico	212.7	325.4	538.1	14.3
3	Canada	255.4	270.4	525.8	14.0
4	Japan	64.1	119.5	183.6	4.9
5	Germany	57.8	115.1	172.9	4.6
6	Korea, South	51.2	76.0	127.2	3.4
7	United Kingdom	59.0	50.2	109.2	2.9
8	Switzerland	18.0	74.8	92.8	2.5
9	Taiwan	30.5	60.4	90.9	2.4
10	Vietnam	10.0	79.6	89.6	2.4

Source: U.S. Department of Commerce, Census Bureau, "Top Trading Partners," https://www.census.gov/foreign-trade/statistics/highlights/top/top2012yr.html (accessed February 22, 2021).

expected the world economic growth to be 5.5 percent and 4.2 percent in 2021 and 2022, respectively,[10] although the lingering economic effects of the COVID-19 pandemic may reduce that. Let's take a quick look at trade with some major nations and regions.

Canada and Western Europe Due in part to sharing a border and language, the economic relationship between the United States and Canada is one of the most efficient, most integrated, and most dynamic in the world. Together, the two nations generated 703.8 billion in bilateral trade in 2019—almost $2 billion a day, or $23,000 every second.[11] The nearly 450 million residents of the European Union make its member countries attractive trading partners, generating an estimated trade in goods of more than $658 billion in 2020.[12] Most other advanced economies, including Norway, Sweden, Switzerland, and the United Kingdom, are also major importers to and buyers of exports from the United States. Thanks in part to stability, similar per capita incomes, and growing economies, these relationships are likely to endure.

Mexico and Latin America Mexico, another leading trading partner, represents a tremendous opportunity for businesses looking for new markets. Latin America is home to 10 Free Trade Area countries and more than 650 million consumers. In addition to Mexico, these countries include Chile, Colombia, Peru, and the six countries of the Dominican Republic-Central America FTA or "CAFTA-DR" (Costa Rica, The Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua). U.S. trade in goods with Central and South American nations added up to $221 billion a year in 2020[13] and is expected to grow as trade barriers among the nations ease.

WORAWEE MEEPIAN/SHUTTERSTOCK.COM

International expansion. Uber continues its globalization efforts by offering its services in more than 10,000 cities worldwide.

Technology and Innovation

Spotify Makes a Play for Global Dominance

Spotify, a Swedish digital music, podcast, and video streaming service, has more than 354 million users in 93 markets. Although the company controls about one-third of the global music-streaming market, it faces steep competition for consumer dollars against Pandora, Apple Music, YouTube Music, Tidal, and Amazon Music, among others. To grow its market share, Spotify is eyeing global expansion.

Spotify sees international growth as an opportunity to stay ahead of the streaming competition. Russia, one of Spotify's latest markets, is the fastest-growing market for music. In addition, Spotify expanded to Albania, Belarus, Bosnia and Herzegovina, Croatia, Kazakhstan, Kosovo, Moldavia, Montenegro, North Macedonia, Serbia, Slovenia, and Ukraine. In each market, Spotify works with local distributors and establishes local partnerships to offer a local experience on a global platform.

Spotify follows a freemium pricing strategy, meaning it offers free entry-level access, hoping to convert free users into premium subscribers. Its premium service eliminates advertisements and allows users to download music, skip an unlimited number of songs, and access Spotify's full library of music. This pricing strategy is not unique, however, as many of its competitors, including Pandora and Amazon Music, also offer free versions of their platforms.

To increase revenue, leadership at Spotify says it will increase subscription prices in mature markets where it offers more value than it did previously. The company has been busy developing and releasing original and exclusive content in 16 markets to differentiate the platform from competitors. Spotify's goal is to solidify its dominance in the audio streaming market while increasing earnings from active subscribers.

Sources: Based on information in Spotify, "Company Info," https://newsroom.spotify.com/company-info/ (accessed February 14, 2021); David Trainer, "It Sounds Like Spotify Is In Trouble," *Forbes*, October 13, 2020, www.forbes.com/sites/greatspeculations/2020/10/13/it-sounds-like-spotify-is-in-trouble; Kenneth Li, Supantha Mukherjee, "Spotify Expands to Russia and 12 Other Countries," *Reuters*, July 14, 2020, www.reuters.com/article/us-spotify-russia/spotify-expands-to-russia-and-12-other-countries-idUSKCN24F2AH; Sarah Perez, "Spotify CEO Says Company Will 'Further Expand Price Increases'," *TechCrunch*, October 29, 2020, www.techcrunch.com/2020/10/29/spotify-ceo-says-company-will-further-expand-price-increases.

Asia Japan is the world's third largest economy and the United States' fourth largest trading partner. China's emergence as a global economic power has been among the most dramatic economic developments of recent decades. Indeed, China has grown to be the world's second largest economy, and the United States shares more than half a trillion dollars in annual bilateral trade. Also, as the emerging middle class in India, the world's largest democracy, buys U.S. products, it means jobs and income for the U.S. middle class. With a market of over 1.35 billion of the world's consumers and per capita incomes expected to grow, India's vast market promises U.S. companies continued strong demand for goods and services.

Africa Sub-Saharan Africa is home to 1.1 billion people in 46 countries with immense natural resources that offer great trade potential. U.S. trade to and from Africa has tripled over the past decade, and U.S. exports of goods to this region now exceed $22 billion.[14] Although some of these nations have experienced conflict and stagnating economies, Ghana, Rwanda, Ethiopia, and others have experienced dramatic economic growth in recent years. Companies are increasingly looking for opportunities in these growing economies, whose residents are younger than average and have growing disposable incomes.

Middle East/North Africa Some of the countries of the Middle East and North Africa (MENA)—particularly Egypt and Saudi Arabia—have become important trading partners to the United States. Although political instability in the region has been a challenge to developing long-term relationships, the vast natural resources and growing per capita incomes make the region desirable to companies.

✓ Concept Check

- Why do firms engage in international trade?
- What is the difference between an absolute advantage and a comparative advantage?
- What is the difference between balance of trade and balance of payments?
- Which nations are the principal trading partners of the United States?

3-2 Methods of Entering International Business

Learning Objective

3-2 Explore the methods by which a firm can organize for and enter into international markets.

A firm that has decided to enter international markets can do so in several ways. These different approaches require varying degrees of involvement, investment, and risk. Typically, a firm begins its international operations at the simplest level. Then, depending on its goals, it may progress to higher levels of involvement. Table 3-3 describes the steps in entering international markets.

3-2a **Exporting**

Exporting can be a relatively low-risk method of expanding operations by entering foreign markets. As an example, the Canadian firm LED Roadway Lighting Ltd. manufactures energy-efficient road lighting products that can help cities and utilities meet their goals to cut costs and reduce their climate footprint. To expand its business beyond Canada, the company began exporting its products to customers

Table 3-3 Steps in Entering International Markets

Step	Activity	Marketing Tasks
1	Identify exportable products	Identify key selling features Identify needs that they satisfy Identify the selling constraints that are imposed
2	Identify key foreign markets for the products	Determine who the customers are Pinpoint what and when they will buy Do market research Establish priority, or "target," countries
3	Analyze how to sell in each priority market (methods will be affected by product characteristics and unique features of country/market)	Locate available government and private-sector resources Determine service and backup sales requirements
4	Set export prices and payment terms, methods, and techniques	Establish methods of export pricing Establish sales terms, quotations, invoices, and conditions of sale Determine methods of international payments, secured and unsecured
5	Estimate resource requirements and returns	Estimate financial requirements Estimate human resources requirements (full- or part-time export department or operation) Estimate plant production capacity Determine necessary product adaptations
6	Establish overseas distribution network	Determine distribution agreement and other key marketing decisions (price, repair policies, returns, territory, performance, and termination). Know your customer (use U.S. Department of Commerce international marketing services)
7	Determine shipping, traffic, and documentation procedures and requirements	Determine methods of shipment (air or ocean freight, truck, rail) Finalize containerization Obtain validated export license Follow export-administration documentation procedures
8	Promote, sell, and be paid	Use international media, communications, advertising, trade shows, and exhibitions Determine the need for overseas travel (when, where, and how often?) Initiate customer follow-up procedures
9	Continuously analyze current marketing, economic, and political situations	Recognize changing factors influencing marketing strategies Constantly reevaluate

Source: U.S. Department of Commerce, International Trade Administration, Washington, DC.

in Caribbean nations, where high power rates allow customers to quickly realize savings from using LED lighting products. LED Roadway Lighting continues to look for new export opportunities such as the United Kingdom.[15] Exporting opens up several levels of involvement to exporting firms.

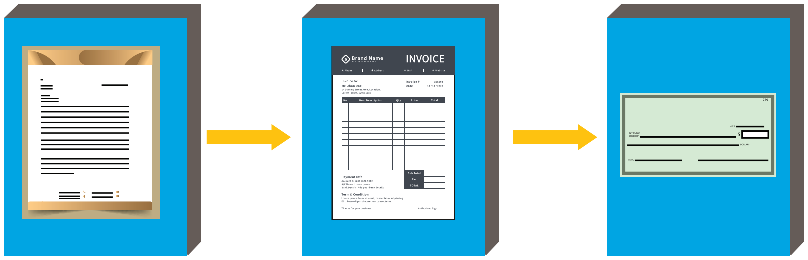
At the most basic level, the exporting firm may sell its products outright to an *export-import merchant,* which is a type of wholesaler specializing in international trade. This merchant assumes all the risks of product ownership, distribution, and sale. It may even purchase the goods in the producer's home country and assume responsibility for exporting the goods. An important and practical issue for domestic firms dealing with foreign customers is securing payment. Figure 3-3 depicts a simplified version of the process. This is a two-sided issue that reflects the mutual concern rightly felt by both parties to the trade deal: The exporter would like to be paid before shipping the merchandise, whereas the importer obviously would prefer to know that it has received the shipment before releasing any funds. Neither side wants to take the risk of fulfilling its part of the deal only to discover later that the other side has not. The result would lead to legal costs and complex, lengthy dealings that would waste everyone's resources. This mutual level of mistrust, in fact, makes good business sense and has been around since the beginning of trade centuries ago. The solution then was the same as it still is today—for both parties to use a mutually trusted go-between who can ensure that the payment is held until the merchandise is in fact delivered according to the terms of the trade contract. The go-between representatives employed by the importer and exporter are still, as they were in the past, the local domestic banks involved in international business.

Alternatively, the exporting firm may ship its products to an *export-import agent,* which arranges the sale of the products to foreign intermediaries for a commission or fee. The agent is an independent firm—like other agents—that sells and may perform other marketing functions for the exporter. The exporter, however, retains title to the products during shipment and until they are sold.

An exporting firm also may establish its own *sales offices,* or *branches,* in foreign countries. These installations are international extensions of the firm's distribution system. They represent a deeper involvement in international business than the other exporting techniques we have discussed—and thus they carry a greater risk. The exporting firm maintains control over sales, and it gains both experience in and knowledge of foreign markets. Eventually, the firm also may develop its own sales force to operate in conjunction with foreign sales offices.

Figure 3-3 **Exporting to International Markets**

After signing contracts, the importer will ask its local bank to issue a *letter of credit* for the funds needed to pay for the merchandise. The transporter of the merchandise provides the exporter evidence of the shipment via a *bill of lading.* The exporter signs over title to the merchandise and issues a *draft* from its bank, which orders the importer's bank to pay for the merchandise.



Another option is via a **trading company**, which provides a link between buyers and sellers in different countries. A trading company, as its name implies, is not involved in manufacturing or owning assets related to manufacturing. It buys products in one country at the lowest price consistent with quality and sells to buyers in another country. An important function of trading companies is taking title to products and performing all the activities necessary to move the products from the domestic country to a foreign country. For example, large grain-trading companies operating out of home offices both in the United States and overseas control a major portion of the world's trade in basic food commodities. These trading companies sell homogeneous agricultural commodities that can be stored and moved rapidly in response to market conditions.

In the early 1990s, many developing nations had major restrictions on converting domestic currency into foreign currency. Therefore, companies that wanted to export had to resort to barter agreements with importers. **Countertrade** is essentially an international barter transaction in which goods and services are exchanged for different goods and services. As an example, Iran has purchased rice and other imports from India with payment in crude oil.[16] Countertrade is still used today, particularly for trade with countries that have difficult relations with the home nation.

3-2b Licensing and Franchising

Licensing and franchising represent slightly more complex arrangements for international trade. **Licensing** is a contractual agreement in which one firm permits another to produce and market its product and to use its brand name in return for a royalty or other compensation. For example, Yoplait yogurt is a French yogurt licensed for production in the United States. The Yoplait brand maintains an appealing French image, and in return, the U.S. producer pays the French firm a percentage of its income from sales of the product.

Licensing is especially advantageous for small manufacturers wanting to launch a well-known domestic brand internationally. For example, Swedish-owned Electrolux licenses many of its products to firms in India, China, and many other countries. Licensing thus provides a simple method for expanding into a foreign market with virtually no investment. On the other hand, if the licensee does not maintain the licensor's product standards, the product's reputation may be damaged.

BUSINESS
OPERATOR
PARTNER
SUPPLIER
DISTRIBUTION
CONCEPT
Franchise
TRADEMARK
TM
LOCATION
$
AGREEMENT
INVESTMENT

TRUEFFELPIX/SHUTTERSTOCK.COM

trading company provides a link between buyers and sellers in different countries

countertrade an international barter transaction

licensing a contractual agreement in which one firm permits another to produce and market its product and to use its brand name in return for a royalty or other compensation

Another possible disadvantage is that a licensing arrangement may not provide the original producer with any foreign marketing experience.

Franchising is similar to licensing in that it is a contractual arrangement for an individual or organization to operate facilities, typically stores, on behalf of another. As we shall see in Chapter 5, a franchisor, such as KFC, allows a franchisee to use the franchisor's brand name and methods of doing business in its own stores in exchange for fees and royalties. This arrangement can enable a popular brand to expand into overseas markets with relatively little investment. Consider that consumers around the world can get donuts, muffins, bagels, and coffee at 3,200 Dunkin' restaurants in 36 countries, in addition to 8,500 restaurants in the United States.[17]

3-2c Contract Manufacturing

Companies that want a little more control over their products and are willing to take on a greater degree of risk may engage in contract manufacturing. **Contract manufacturing** occurs when one firm employs another business—often in another country—to manufacture its products or product components to the domestic firm's specifications. The resulting product typically carries the domestic firm's name. In fact, many U.S. companies use contract manufacturing to take advantage of lower labor costs in other countries, which can help lower the prices of their products to consumers. Contract manufacturing is used far more often than you might guess, and it is common in the electronics, automotive, and fashion industries, among others. Consider Swedish fast-fashion retailer H&M, which contracts with hundreds of different companies in 40 countries to produce its trendy clothing. Recently, the firm has begun identifying the company, country, and even factory producing each item of clothing for interested consumers and stakeholders.[18]

Indeed, **outsourcing**, the contracting of manufacturing and/or other activities to overseas companies that specialize in those activities and can offer them at a lower cost, has become very common in recent years. Many companies have achieved significant cost savings from outsourcing manufacturing to countries such as China, India, Bangladesh, Vietnam, and the Philippines, where labor costs and taxes are significantly lower than in the United States. In most cases, these savings are passed on to shareholders and to consumers in the form of lower prices. However, outsourcing is controversial because it has resulted in the loss of American manufacturing jobs and higher unemployment in manufacturing sectors. Moreover, human rights violations at some overseas factories have resulted in worker deaths and injuries as well as harm to the reputations of firms that contract to them.

contract manufacturing an arrangement in which one firm contracts with another business, often in another country, to manufacture products or product components to its specifications

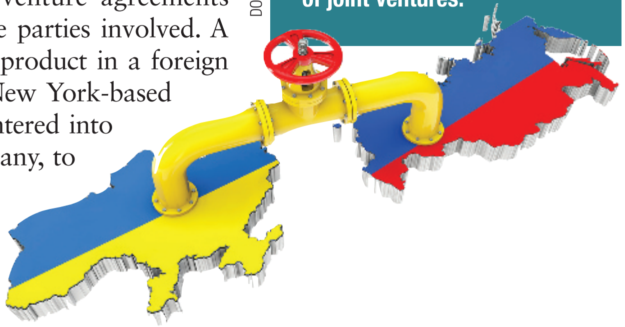
outsourcing an arrangement in which one firm contracts manufacturing or other activities to a firm in another country that specializes in those activities and can offer them at a lower cost than domestic firms

strategic alliance a partnership formed to create competitive advantage on a worldwide basis

3-2d Joint Ventures and Alliances

A *joint venture* is a partnership formed to achieve a specific goal or to operate for a specific period of time. A joint venture with an established firm in a foreign country provides immediate market knowledge and access, reduced risk, and control over product attributes. However, joint-venture agreements established across national borders can become extremely complex. As a result, joint-venture agreements generally require a very high level of commitment from all the parties involved. A joint venture may be used to produce and market an existing product in a foreign nation or to develop an entirely new product. For example, New York-based Pfizer, one of the world's leading pharmaceutical companies, entered into a joint venture with BioNTech, a German biotechnology company, to create and distribute a vaccine for the COVID-19 virus.[19]

A **strategic alliance**, a more recent form of international business structure, is a partnership formed to create competitive advantage on a worldwide basis. Strategic alliances are very similar to joint ventures. The number of



Joint venture. Large pipelines can involve multiple countries. They can be organized based on the use of joint ventures.

DOOMU/SHUTTERSTOCK.COM

strategic alliances is growing at an estimated rate of about 20 percent per year. In fact, in the automobile and computer industries, strategic alliances are becoming the predominant means of competing. International competition is so fierce and the costs of competing on a global basis are so high that few firms have all the resources needed to do it alone. Thus, individual firms that lack the internal resources essential for international success may seek to collaborate with other companies. An example of such an alliance is the agreement between Honda and General Motors to collaborate to make electric vehicles using technologies from both firms.[20]

3-2e **Direct Investment**

At a still deeper level of involvement in international business, a firm may invest directly in its own facilities, that is, its own production and marketing facilities in one or more foreign nations. This *direct investment* provides complete control over operations, but it carries a greater risk than the joint venture. The firm is really establishing a subsidiary in a foreign country. Most firms do so only after they have engaged in simpler levels of international trade and acquired some knowledge of the host country's markets.

Direct investment may take either of two forms. In the first, the company builds or purchases manufacturing and other facilities in a foreign country. It uses these facilities to produce its own established products and to market them in that country and perhaps in neighboring countries. Firms such as General Motors, Dow Chemical, and Colgate-Palmolive are multinational companies with worldwide manufacturing facilities.

A second form of direct investment in international business is the purchase of an existing firm in a foreign country under an arrangement that allows it to operate independently of the parent company. When Sony Corporation (a Japanese firm) decided to enter the motion picture business in the United States, it chose to purchase Columbia Pictures Entertainment, Inc., rather than start a new motion picture studio from scratch.

✓ Concept Check

- List the most common methods of entering international business.
- Two methods of engaging in international business may be categorized as either direct or indirect. How would you classify each of the methods described in this chapter? Why?
- In what ways is a multinational corporation different from a large corporation that does business in several countries?

3-2f **Multinational Firms**

A **multinational corporation** is a firm that operates on a worldwide scale without ties to any specific nation or region. The multinational firm represents the highest level of involvement in international business. It is equally "at home" in most countries of the world. In fact, as far as the operations of the multinational enterprise are concerned, national boundaries exist only on maps. It is, however, organized under the laws of its home country. Table 3-4 shows the ten largest foreign and U.S. public multinational companies; the ranking is based on a composite score reflecting each company's best three out of four rankings for sales, profits, assets, and market value.

multinational corporation a firm that operates on a worldwide scale without ties to any specific nation or region

Table 3-4 The Ten Largest Foreign and U.S. Multinational Corporations

Rank	Company	Business	Country	Revenue ($ millions)
1	Walmart	General Merchandise	United States	523,964
2	Sinopec	Energy	China	407,009
3	State Grid	Power Grids	China	383,906
4	China National Petroleum	Energy	China	379,130
5	Royal Dutch Shell	Energy	Netherlands	352,106
6	Saudi Aramco	Petroleum	Saudi Arabia	329,784
7	Volkswagen	Automobiles	Germany	282,760
8	BP	Energy	United Kingdom	282,616
9	Amazon	Internet and Retail	United States	280,522
10	Toyota	Automobiles	Japan	275,288

Source: "Global 500," *Fortune*, http://fortune.com/global500/ (accessed February 22, 2021).

Sustaining the Planet

IKEA Opens Its First Second-Hand Store

IKEA, a ready-to-assemble furniture retailer, has a reputation for sustainability. The company's goal is to become 100 percent circular. The term *circular economy* refers to an economic system that eliminates waste and keeps products in use. For IKEA, this translates to creating products with renewable or recycled materials, helping customers extend the life of their products, and developing circular capabilities in its supply chain. One way IKEA is achieving this is through its secondhand store concept.

IKEA opened its first secondhand store in Sweden, its home country. Consumers donate their furniture at municipal recycling centers. The furniture is repaired or repurposed in IKEA's repair shop and then sold below the item's initial price. IKEA's goal is to be circular by 2030. By then, the company also aims to reduce more greenhouse gas emissions than emitted by its value chain. Helping customers get more use out of their products is key to achieving both goals.

The store is located in ReTuna Shopping Centre, a mall where all products sold are either reused or recycled. IKEA hopes to learn more about secondhand retail, including how to attract shoppers and what causes customers to donate products. To incentivize individuals to return old IKEA furniture, the company offered local customers vouchers. If IKEA's secondhand store is successful, it will roll out the concept in additional markets.

Sources: Based on information in Anna Ringstrom, "IKEA Opens Pilot Second-Hand Store in Sweden," *World Economic Forum*, October 30, 2020, www.weforum.org/agenda/2020/10/ikea-opens-pilot-second-hand-store-sweden-circular-economy; IKEA, "Why the Future of Furniture Is Circular," https://about.ikea.com/en/sustainability/a-world-without-waste/why-the-future-of-furniture-is-circular.

3-3 International Business Challenges

Learning Objective

3-3 Discuss the challenges businesses face when entering international markets, especially the restrictions nations place on international trade.

Specialization and international trade can result in the efficient production of want-satisfying goods and services on a worldwide basis. As we have noted, international business generally is increasing. Yet the nations of the world continue to erect barriers to free trade. They do so for reasons ranging from internal political and economic pressures to simple mistrust of other nations. In this section, we examine the types of trade restrictions that nations may apply, the arguments for and against trade restrictions, and additional challenges to international trade.

3-3a Trade Restrictions

Nations generally are eager to export their products. They want to provide markets for their industries and to develop a favorable balance of trade. Hence, most trade restrictions are applied to imports from other nations.

Tariffs Perhaps the most commonly applied trade restriction is the tariff, also known as a customs or import duty. A **tariff** is a tax levied on a particular foreign product entering a country. For example, the United States imposed a 2.2 percent import duty on fresh Chilean tomatoes, an 8.7 percent duty if tomatoes are dried and packaged, and nearly 12 percent if tomatoes are made into ketchup or salsa. Two types of tariffs are revenue tariffs and protective tariffs; both have the effect of raising the price of the product in the importing nations, but for different reasons. *Revenue tariffs* are imposed solely to generate income for the government. *Protective tariffs,* on the other hand, are imposed to protect a domestic industry from competition by keeping the price of competing imports level with or higher than the price of similar domestic products. Because fewer units of the product will be sold at the increased price, fewer units will be imported. The French and Japanese agricultural sectors would both shrink drastically if their nations abolished the protective tariffs that

tariff a tax levied on a particular foreign product entering a country keep the price of imported farm products high. In recent years, the United States has imposed significantly greater tariffs on imports of products from around the world, ranging from Scotch whiskey to Chinese electronics, ostensibly to protect domestic industries from foreign competition. However, when countries alter their trade policies to include more tariffs, other countries are likely to respond in kind, which can lead to a *trade war* that oftentimes harms producers in all involved countries.

Some countries rationalize their protectionist policies as a way of offsetting an international trade practice called *dumping*. **Dumping** is the exportation of large quantities of a product at a price lower than that of the same product in the home market. Thus, dumping drives down the price of the domestic item. Recently, the Foil Trade Enforcement Working Group of the Aluminum Association, which represents U.S. aluminum manufacturers, claimed that low-priced aluminum foil from Armenia, Brazil, Oman, Russia, and Turkey was being sold in the United States at less than fair value prices. The producers contend that the dumped foil is harming the domestic industry, and they therefore asked to obtain an antidumping duty through the government to offset the advantage of the foreign product.[21] In another example, the United States imposes tariffs on Chinese tire makers in response to past dumping in the United States.[22]

Nontariff Barriers A **nontariff barrier** is a nontax measure imposed by a government to favor domestic over foreign suppliers. Nontariff barriers create obstacles to the marketing of foreign goods in a country and increase costs for exporters. The following are a few examples of government-imposed nontariff barriers:

- An **import quota** is a limit on the amount of a particular good that may be imported into a country during a given period of time. The limit may be set in terms of either quantity (so many pounds of beef) or value (so many dollars' worth of shoes). Quotas also may be set on individual products imported from specific countries. Once an import quota has been reached, imports are halted until the specified time has elapsed.
- An **embargo** is a complete halt to trading with a particular nation or of a particular product. The embargo is used most often as a political weapon. At present, the United States has import embargoes against Iran and North Korea—both the result of extremely poor political relations.
- An **exchange control** is a restriction on the amount of a particular foreign currency that can be purchased or sold. By limiting the amount of foreign currency importers can obtain, a government limits the amount of goods importers can purchase with that currency. This has the effect of limiting imports from the country whose foreign exchange is being controlled.
- A nation can increase or decrease the value of its money relative to the currency of other nations. **Currency devaluation** is the reduction of the value of a nation's currency relative to the currencies of other countries.

Devaluation increases the cost of foreign goods, whereas it decreases the cost of domestic goods to foreign firms. For example, suppose that the British pound is worth $2. In this case, an American-made $2,000 computer can be purchased for £1,000. However, if the United Kingdom devalues the pound so that it is worth only $1, that same computer will cost £2,000. The increased cost, in pounds, will reduce the import of American computers—and all foreign goods—into England. On the other hand, before devaluation, a £500 set of English bone china will cost an American $1,000. After the devaluation, the set of china will cost only $500. The decreased cost will make the china—and all English goods—much more attractive to U.S. purchasers.

Bureaucratic red tape is more subtle than the other forms of nontariff barriers. Yet it can be the most frustrating trade barrier of all. A few examples are the restrictive application of standards and complex requirements related to product testing, labeling, and certification.

dumping exportation of large quantities of a product at a price lower than that of the same product in the home market

nontariff barrier a nontax measure imposed by a government to favor domestic over foreign suppliers

import quota a limit on the amount of a particular good that may be imported into a country during a given period of time

embargo a complete halt to trading with a particular nation or of a particular product

exchange control a restriction on the amount of a particular foreign currency that can be purchased or sold

currency devaluation the reduction of the value of a nation's currency relative to the currencies of other countries

Reasons for and against Trade Restrictions Various reasons are given for trade restrictions either on the import of specific products or on trade with particular countries. We have noted that political considerations usually are involved in trade embargoes. Other frequently cited reasons for restricting trade include the following:

- *To equalize a nation's balance of payments.* This may be considered necessary to restore confidence in the country's monetary system and in its ability to repay its debts.
- *To protect new or weak industries.* A new, or infant, industry may not be strong enough to withstand foreign competition. Temporary trade restrictions may be used to give it a chance to grow and become self-sufficient. Of course, once an industry is protected from foreign competition, it may not want to give up the protections, and these "temporary" trade restrictions may become permanent.
- *To protect national security.* Restrictions in this category generally apply to technological products that must be kept out of the hands of potential enemies. For example, strategic and defense-related goods cannot be exported to unfriendly nations.
- *To protect the health of citizens.* Products may be embargoed because they are dangerous or unhealthy (e.g., farm products contaminated with insecticides).
- *To retaliate for another nation's trade restrictions.* A country whose exports are taxed by another country may respond by imposing tariffs on imports from that country. In the late 2010s, the United States and China became embroiled in a trade war for this reason.
- *To protect domestic jobs.* By restricting imports, a nation can protect jobs in domestic industries. However, while protectionist policies can have positive effects in the short run, they can be harmful in the long term.

WANG AN QI/SHUTTERSTOCK.COM

Restricting trade through tariffs. Due to the recent increase in inexpensive solar products from China and Taiwan, many American manufacturers were forced out of business. To help fix this issue, the United States placed a tariff on Chinese- and Taiwanese-produced solar panels. Some industry experts believe that the increased prices caused by the tariffs could curb the adoption of solar energy in the United States.

Trade restrictions have immediate and long-term economic consequences—both within the restricting nation and in world trade patterns. These include the following:

- *Higher prices for consumers.* Higher prices may result from the imposition of tariffs or the elimination of foreign competition, as described earlier. For example, imposing quota restrictions and import protections adds $25 billion annually to U.S. consumers' apparel costs by directly increasing costs for imported apparel.
- *Restriction of consumers' choices.* Again, this is a direct result of the elimination of some foreign products from the marketplace and of the artificially high prices that importers must charge for products that are still imported.
- *Misallocation of international resources.* The protection of weak industries results in the inefficient use of limited resources. The economies of both the restricting nation and other nations eventually suffer because of this waste.
- *Loss of jobs.* The restriction of imports by one nation must lead to cutbacks—and the loss of jobs—in the export-oriented industries of other nations. Furthermore, trade protection has a significant effect on the composition of employment. U.S. trade restrictions—whether on textiles, apparel, steel, or automobiles—benefit only a few industries while harming many others. The gains in employment

> accrue to the protected industries and their primary suppliers, and the losses are spread across all other industries. A few states gain employment, but many other states lose employment.

Consider that former President Donald Trump's protectionist policies—intended to slash the nation's trade deficit with China and stem job losses in American manufacturing—ultimately did neither. Instead, Trump's trade policy, which relied heavily on tariffs, resulted in a trade war with China which ultimately raised the prices of important Chinese imports while reducing American exports to China, at a cost of American jobs in affected industries. While jobs did grow in a few industries, so did the trade deficit with China.[23]

3-3b **Economic Challenges**

Businesspeople desiring to engage in international trade must also recognize that there are likely to be differences in countries' standards of living, individual income and buying power, national resources, and infrastructure. Among the world's nations, the United States has the highest GDP, which we defined in Chapter 1 as the value of all products produced by all people within a nation in a specified time period. While GDP can provide an estimate of the size of a national economy, businesspeople are often more interested in per capita GDP (a nation's GDP divided by its population) as this gives more insight into a nation's standard of living and market potential. Consider that the GDP per capita of the United States is $63,051, yet a number of countries have higher rates of GDP per capita, including Switzerland, Norway, and Luxembourg.[24] Businesspeople can also find tremendous opportunities in countries with far less incomes. The countries of Brazil, Russia, India, China, and South Africa (BRICS) have in recent years experienced rapid economic expansion and growing middle classes, making them very attractive markets for companies looking to develop their brands.

Another economic challenge is that in most cases nations use different currencies. The value of the American dollar, European euro, and the Japanese yen has a significant impact on product prices in most countries. Many countries allow the value of their currencies to float, or fluctuate according to supply and demand on the foreign exchange market. In recent times, the value of the U.S. dollar has been strong relative to other currencies. This means that U.S. exports cost more when purchased using euros in Europe or renminbi in China. Because the value of a nation's currency can change from day to day, the change in value can also affect how much profit (or loss) a firm may realize on an international transaction.

Another factor that can affect the attractiveness of and opportunities within another country is its level of *infrastructure*—the transportation, energy transmission, communication networks, and other systems that facilitate the functions of civilization. Developing countries may have less reliable infrastructure systems, which may create challenges when introducing certain types of products. On the other hand, a lack of communications and utility infrastructure in some countries spurred entrepreneurs to invest in wireless and alternative energy technologies and solutions at a faster rate than in the United States. As an example, in many developing countries, a significant percentage of the population lacks reliable access to banking services. Safaricom, a large Kenyan telecom provider, partnered with banks, nonprofit organizations, and microcredit organizations to launch M-Pesa, a payment platform. M-Pesa functions as a digital wallet allowing users to send and receive payments via an app and to save and withdraw funds from Safaricom retail stores throughout Kenya. As M-Pesa grew and competing apps from other telecoms proliferated, these services have boosted the percentage of Kenyans using financial services from 26 percent to 75 percent in just a decade.[25]

Ethics and Social Responsibility

Opening the Gates to Digital Payments

It may be surprising to learn that digital payment services have been established in developing countries for more than a decade. M-Pesa, a mobile phone-based money transfer and financing service, serves millions in Kenya who previously were limited to cash and informal networks, lifting nearly 200,000 individuals out of poverty. Now, a coalition of nonprofits and tech companies, including the Bill and Melinda Gates Foundation and Google, want to build on the digital payment revolution M-Pesa started.

The coalition, called Mojaloop Foundation, will facilitate the development of real-time digital payment systems through an open-source platform. Open-source software includes the source code so developers can alter and distribute it. One major goal is to digitally connect the fragmented financial service offerings currently available such as M-Pesa. M-Pesa and its imitators are mostly privately owned and operated, often resulting in high transaction fees between systems. Mojaloop Foundation aims to reduce friction.

Bridging the gap between these banking and payment systems could add value to each service rather than pitting them against each other as competitors. Another of Mojaloop's goals is to boost the global economy. Studies show that when affordable digital finance tools are available in developing nations, economies grow by 6 percent. But providing the software is only one piece of the puzzle. Mojaloop will also connect experts with countries to tackle problems and influence government policies.

Sources: Based on information in David Z. Morris, "Google and Gates Foundation to Help Spread Digital Payments in Developing Countries," *Fortune*, May 6, 2020, www.fortune.com/2020/05/06/google-gates-foundation-digital-payments-developing-countries; Mojaloop Foundation, "Mission," www.mojaloop.io/foundation/mission.

3-3c **Legal and Political Climate**

Beyond infrastructure and economic issues, the laws, regulatory agencies, political systems, and special-interest groups within a country all have a great impact on international business. In the United States, as in many countries, the political, legal, and regulatory forces of the environment are closely interconnected. Even when different countries seem similar, differences in legal, political, or regulatory conditions in their home countries can shape trade. We have already mentioned some of the challenges that businesses may face when they engage in international trade: trade restrictions such as tariffs and import quotas often are the result of the political will within the country.

Additionally, rules that Americans take for granted may differ in other nations. Privacy rules in Europe, for example, are considerably stricter than within the United States, as are rules related to advertising to children. On the other hand, the use of payoffs and bribes is common in many parts of the world, but U.S. law prohibits direct involvement in payoffs and bribes by American businesspersons and companies. The Foreign Corrupt Practices Act (FCPA) of 1977 also makes it illegal for U.S. firms to attempt to make large payments or bribes to influence policy decisions of foreign governments. These laws can make it challenging for U.S. companies to compete with foreign firms that do engage in these practices.

3-3d **Social and Cultural Barriers**

One of the most significant barriers to international trade relates to social and cultural issues. Differences due to religious institutions, values, customs, social systems, and language can affect communications, negotiations, and perceptions of products and companies. Obviously, language can be problematic when translating advertising and other communications into other languages. On more than one occasion, such efforts led to comical yet potentially disastrous situations. For example, KFC's long-running slogan "Finger lickin' good" was translated in China as "Eat your fingers off," while Schweppes' carbonated water was translated in Italy as "toilet water."[26] Even when language is shared, words may still mean different things. Consider that "football" is a leading sport outside the United States—but the term refers to what Americans call soccer.

Cultural barriers can impede acceptance of products in foreign countries. For example, illustrations of feet are regarded as offensive in Thailand. Even so simple a thing as the color of a product or its package can present a problem. In Japan, black and white are the colors of mourning, so they should not be used in packaging. In Brazil, purple is the color of death. And in Egypt, green is never used on a package because it is the national color. Many retailers on the internet have yet to come to grips with the task of designing an online shopping site that is attractive and functional for all global customers. When customers are unfamiliar with particular products from another country, their general perceptions of the country itself affect their attitude toward the product and help to determine whether they will buy it.

✓ Concept Check

- List and briefly describe the principal restrictions that may be applied to a nation's imports.
- What reasons are generally given for imposing trade restrictions?
- What are some economic challenges that businesspeople need to consider in international trade?
- How can the political and legal climate of a nation affect trade?
- Describe some social and cultural factors that can influence product acceptance in another country.

3-4 Facilitators of International Trade

Although the previous pages may make international trade seem daunting, there are many organizations and agreements that facilitate trade across national borders, including the World Trade Organization (WTO) and numerous free trade agreements.

Learning Objective

3-4 Identify the facilitators of international trade, including international trade agreements and international economic organizations working to foster trade.

3-4a The General Agreement on Tariffs and Trade and the World Trade Organization

At the end of World War II, the United States and 22 other nations organized the body that came to be known as GATT. The **General Agreement on Tariffs and Trade (GATT)** was an international organization of 164 nations dedicated to reducing or eliminating tariffs and other barriers to world trade. Headquartered in Geneva, Switzerland, GATT provided a forum for tariff negotiations and a means for settling international trade disputes and problems. It also conferred "most-favored-nation status (MFN)," meaning that each GATT member nation was to be treated equally by all contracting nations. Therefore, MFN ensured that any tariff reductions or other trade concessions were extended automatically to all GATT members.

From 1947 to 1994, the body sponsored eight rounds of negotiations to reduce trade restrictions. Three were especially constructive. The *Kennedy Round,* which began in 1964, was successful in reducing tariffs and other barriers to trade in industrial and agricultural products by an average of more than 35 percent. The *Tokyo Round,* which was completed in 1979, negotiated phased tariff cuts of 30 to 35 percent and removed or eased nontariff barriers such as import quotas, unrealistic quality standards for imports, and unnecessary red tape in customs procedures. In 1986, the *Uruguay Round* was able to lower tariffs by greater than one-third, reform trade in agricultural goods, write new rules of trade for intellectual property and services, and strengthen the dispute-settlement process. Arguably the most significant result of the Uruguay Round was the creation of the World Trade Organization (WTO) on January 1, 1995. The **World Trade Organization (WTO)** is an international forum that facilitates world trade among member nations by mediating disputes and fostering continued efforts to reduce trade barriers. Membership in the WTO obliges 164 member nations to observe GATT rules.

General Agreement on Tariffs and Trade (GATT) an international organization of nations dedicated to reducing or eliminating tariffs and other barriers to world trade

World Trade Organization (WTO) powerful successor to GATT that facilitates world trade among member nations by mediating disputes and fostering efforts to reduce trade barriers

economic community an organization of nations formed to promote the free movement of resources and products among its members and to create common economic policies

3-4b International Trade Agreements and Alliances

The primary objective of the WTO is to remove barriers to trade on a worldwide basis. On a smaller scale, an **economic community** is an organization of nations formed to promote the free movement of resources and products among its members and to create common economic policies. A number of economic communities now exist.

ANGEL SOLER GOLLONET/SHUTTERSTOCK.COM

USMCA. The United States-Mexico-Canada Agreement has unlocked opportunities for millions of Americans by supporting Made-in-America jobs and exports. Many American small business exporters' first customers are in Canada or Mexico.

The United States-Mexico-Canada Agreement (USMCA) The *United States-Mexico-Canada Agreement (USMCA)* joined the United States with its first- and second-largest export trading partners, Canada and Mexico, in 2020. USMCA replaced an earlier accord, the *North American Free Trade Agreement (NAFTA)*, which went into effect in 1994. NAFTA gradually eliminated tariffs on goods produced and traded among the three nations and created a free trade area of more than 503 million people. After 25 years, NAFTA succeeded in its core goals of expanding trade and investment between the United States, Canada, and Mexico. For example, from 1993 to 2017, trade among the NAFTA nations increased nearly four-fold to $1.3 trillion, significantly more than U.S. trade with other countries.[27] Companies in all three nations experienced growth in exports, while consumers gained better prices and selection.

However, NAFTA critics maintained that it resulted in the loss of American jobs to Mexico, harmed workers by eroding labor standards, undermined national sovereignty, and did nothing to help the environment. Moreover, the original accord was unable to address technological changes that had occurred since its implementation, particularly with regard to intellectual property rights. Some critics felt that Mexico and Canada got more out of the deal than the United States. In 2018, the three nations began renegotiating the agreement that ultimately became the United States-Mexico-Canada Agreement.

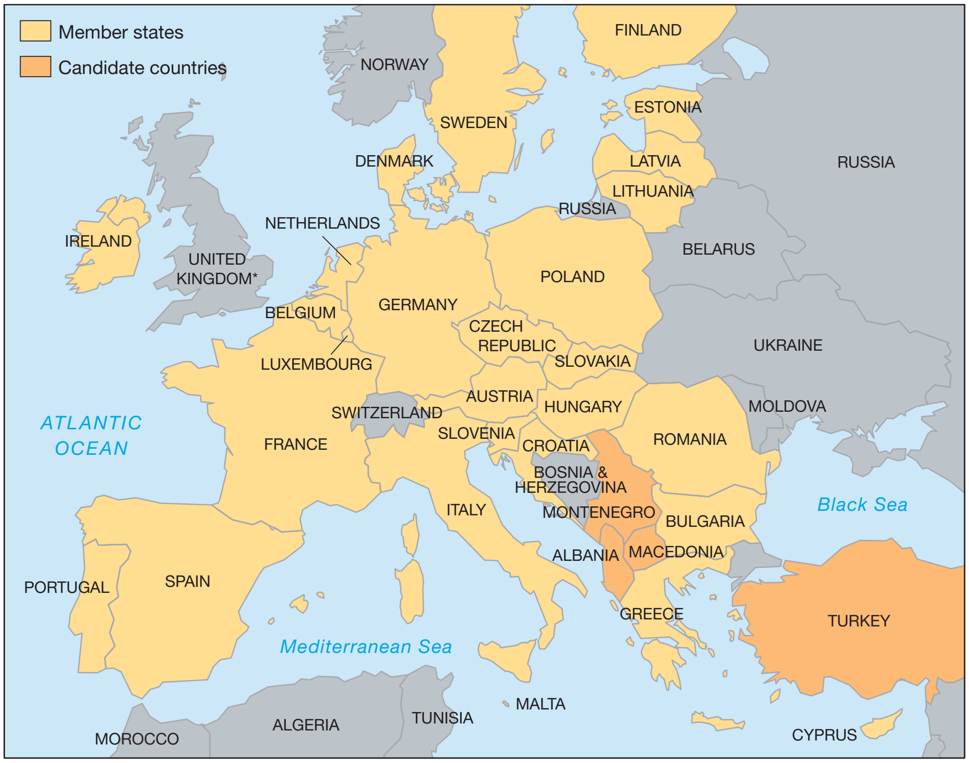
USMCA retains a number of NAFTA's provisions but updates it in significant ways:

- The agreement will be formally reviewed at least every six years to ensure that it remains beneficial to all three nations.
- It has significant dispute resolution systems, which the prior agreement lacked.
- It strengthens labor laws and provides for greater enforcement of them, creating a more equitable situation for U.S. workers.
- It includes provisions related to digital technology and intellectual property.
- It includes funds to address environmental issues stemming from trade between the three nations.[28]

The European Union Operating as a single market with 27 countries, the European Union (EU), also known as the European Economic Community and the Common Market, was formed in 1957 by six countries—France, the Federal Republic of Germany, Italy, Belgium, the Netherlands, and Luxembourg. Its objective was freely conducted commerce among these nations and others that might later join. As shown in Figure 3-4, many more nations have joined the EU since then. The citizens of the United Kingdom voted in 2016 to exit the European Union; however, "Brexit" did not actually go into effect until January 2020. The EU, with a population of 450 million, is now an economic force to be recognized by even the most advanced economies such as of the United States and Japan.

Since 2002, 19 member nations of the EU have been participating in a common currency, the euro, which facilitates trade by removing the need to convert different

Figure 3-4 **The Evolving European Union**


Member states
Candidate countries
NORWAY
FINLAND
SWEDEN
ESTONIA
LATVIA
LITHUANIA
RUSSIA
DENMARK
RUSSIA
IRELAND
NETHERLANDS
UNITED KINGDOM*
BELARUS
POLAND
BELGIUM
GERMANY
CZECH REPUBLIC
UKRAINE
LUXEMBOURG
SLOVAKIA
AUSTRIA
HUNGARY
MOLDOVA
SWITZERLAND
ATLANTIC OCEAN
SLOVENIA
CROATIA
ROMANIA
FRANCE
BOSNIA & HERZEGOVINA
ITALY
MONTENEGRO
BULGARIA
Black Sea
ALBANIA
MACEDONIA
PORTUGAL
SPAIN
GREECE
TURKEY
Mediterranean Sea
MALTA
ALGERIA
TUNISIA
MOROCCO
CYPRUS

Source: europa.eu/european-union/about-eu/countries_en (accessed January 18, 2021).

currencies used in transactions across borders. The euro, used by over 341 million Europeans, is the single currency of the European Monetary Union nations. However, the remaining eight EU members still maintain their own currencies.

The Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) The Central American Free Trade Agreement (CAFTA) was created in 2003 by the United States and four Central American countries—El Salvador, Guatemala, Honduras, and Nicaragua. The CAFTA became CAFTA-DR when the Dominican Republic joined the group in 2007. Costa Rica joined CAFTA-DR as the sixth member in 2009. CAFTA-DR creates the third-largest U.S. export market in Latin America, behind only Mexico and Brazil.

The Association of Southeast Asian Nations (ASEAN) The Association of Southeast Asian Nations, with headquarters in Jakarta, Indonesia, was established in 1967 to promote political, economic, and social cooperation among its seven member countries: Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, and Vietnam. With three new members, Cambodia, Laos, and Myanmar, this region of more than 667 million people, and GDP of $3.3 trillion, is already our fifth-largest trading partner.

The Commonwealth of Independent States The Commonwealth of Independent States was established in December 1991 as a free trade association of 11 republics of the former Soviet Union. Today, its members include Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, and Uzbekistan. Ukraine and Georgia no longer participate.

Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) In 2011, the leaders of twelve countries—Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, and the United States—agreed to form the Trans-Pacific Partnership, which would have been the world's largest free trade agreement. However, the United States withdrew from the agreement in 2017, and the remaining members renegotiated the treaty, which then became known as the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership*. This partnership will boost the economies of the member countries, lower barriers to trade and investment, increase exports, and create more jobs. There is speculation that the United States may rejoin the free trade agreement after the election of President Joseph R. Biden.

The Common Market of the Southern Cone (MERCOSUR) Headquartered in Montevideo, Uruguay, the *Common Market of the Southern Cone (MERCOSUR)* was established in 1991 under the Treaty of Asuncion to unite Argentina, Brazil, Paraguay, and Uruguay as a free-trade alliance; Venezuela became a member later. In more recent times, Colombia, Ecuador, Peru, Bolivia, Chile, Guyana, and Surinam have enrolled as associate members.

✓ Concept Check

- Define and describe the major objectives of the World Trade Organization (WTO) and the international economic communities.
- What is the U.S.-Mexico-Canada Agreement (USMCA)? What is its importance for the United States, Canada, and Mexico?

3-5 Sources of Export Assistance

Learning Objective

3-5 Describe sources of export assistance.

There are a number of federal and state agencies that can assist U.S. firms interested in developing export-promotion programs. The services and programs of these agencies can help American firms to compete in foreign markets and create new jobs in the United States. As an example, the state of Texas, one of the leading exporting states, offers several programs, resources, and even grants for small and medium-sized Texas companies looking to export their products. The state's Export Assistance Program can also facilitate the participation of delegations of small businesses in export-oriented trade shows and missions around the world.[29] Table 3-5 provides an overview of selected U.S. government export assistance programs.

These and other sources of export information enhance the business opportunities of U.S. firms seeking to enter expanding foreign markets. Another vital energy factor is financing.

✓ Concept Check

- List some key sources of export assistance. How can these sources be useful to small business firms?

Table 3-5 U.S. Government Export Assistance Programs

International Trade Administration https://www.trade.gov/	Promotes trade and investment and enforces U.S. trade laws and agreements
U.S. Commercial Service https://www.trade.gov/let-our-experts-help-0	Part of the International Trade Administration; offers assistance and information to exporters through its domestic and overseas commercial offices
Advocacy Center https://www.trade.gov/advocacy	Part of the International Trade Administration; assists U.S. firms competing for major projects with foreign governments
Small Business Administration U.S. Export Assistance Centers https://www.sba.gov/business-guide/grow-your-business/export-products	Provide assistance in export marketing and trade finance
Small Business Administration, Office of International Trade www.sba.gov/oit/	Publishes many helpful guides to assist small and medium-sized companies

3-6 Financing International Business

Learning Objective

3-6 Identify institutions that can help businesses and nations finance international business.

International trade compounds the concerns of financial managers. Currency exchange rates, tariffs and foreign exchange controls, and the tax structures of host nations all affect international operations and the flow of cash. In addition, financial managers must be concerned both with the financing of their international operations and with the means available to their customers to finance purchases.

Fortunately, along with business in general, a number of large banks have become international in scope. Many banks have established branches in major cities around the world. Citi, for example, provides banking and finance services to both consumer and business customers in offices in 96 countries.[30] Thus, like firms in other industries, they can provide services to their customers where and when they are needed. In addition, financial assistance is available from U.S. government and international sources.

One such source is the U.S. Small Business Administration, which provides up to $5 million in short-term loans to U.S. small business exporters. The agency also provides up to $500,000 in export development financing to buy, produce goods, or provide services for exports to small businesses that have exporting potential but need funds to cover the initial costs of entering an export market. Several of today's international financial organizations were founded many years ago to facilitate free trade and the exchange of currencies among nations. Some, such as the Inter-American Development Bank, are supported internationally and focus on developing countries. Others, such as the Export-Import Bank, are operated by one country but provide international financing.

3-6a The Export-Import Bank of the United States

Export-Import Bank of the United States an independent agency of the U.S. government whose function is to assist in financing the exports of American firms

The **Export-Import Bank of the United States**, created in 1934, is an independent agency of the U.S. government whose function is to assist in financing the exports of American firms. *Ex-Im Bank,* as it is commonly called, extends and guarantees credit to overseas buyers of American goods and services and guarantees short-term financing for exports. It also cooperates with commercial banks in helping American exporters to offer credit to their overseas customers. In the last decade, Ex-Im Bank

Mission possible. The Export-Import Bank of the United States (Ex-Im Bank), with 87 years of experience, is the official export credit agency of the United States. Ex-Im Bank's mission is to assist in financing the export of U.S. goods and services to international markets. Its goal is to end extreme poverty by 2030, promote shared prosperity, and support the global sustainable development agenda.

EXPORT-IMPORT BANK OF THE UNITED STATES
DEPARTMENT OF VETERANS AFFAIRS

PAMELA AU/SHUTTERSTOCK.COM

has supported more than 1.44 million jobs in the United States. In 2019, nearly 90 percent of the Bank's transactions—nearly 2,100—directly supported American small businesses.[31]

3-6b The World Bank

A **multilateral development bank (MDB)** is an internationally supported bank that provides loans to developing countries to help them grow. The most familiar is the **World Bank**, a cooperative of 189 member countries, which operates worldwide. Established in 1944 and headquartered in Washington, DC, the bank provides low-interest loans, interest-free credits, and grants to developing countries. The loans and grants help these countries to:

- supply safe drinking water
- build schools and train teachers
- increase agricultural productivity
- expand citizens' access to markets, jobs, and housing
- improve healthcare and access to water and sanitation
- manage forests and other natural resources
- build and maintain roads, railways, and ports, and
- reduce air pollution and protect the environment.[32]

In addition to the World Bank, four other MDBs operate primarily in Central and South America, Asia, Africa, and Eastern and Central Europe. All are supported by the industrialized nations, including the United States.

The Inter-American Development Bank The *Inter-American Development Bank (IDB),* the oldest and largest regional bank, was created in 1959 by 19 Latin American countries and the United States. The bank, which is headquartered in Washington, DC, makes loans and provides technical advice and assistance to countries. Today, the IDB is owned by 48 member nations.

The Asian Development Bank With 68 member nations, the *Asian Development Bank (ADB),* created in 1966 and headquartered in the Philippines, promotes economic and social progress in Asian and Pacific regions. The U.S. government is the second-largest contributor to the ADB's capital, after Japan.

The African Development Bank The African Development Bank (AFDB), also known as *Banque Africaines de Development*, was established in 1964 with headquarters in Abidjan, Ivory Coast. Its members include 54 African and 27 non-African countries from the Americas, Europe, and Asia. The AFDB's goal is to foster the economic and social development of its African members. The bank pursues this goal through loans, research, technical assistance, and the development of trade programs.

European Bank for Reconstruction and Development Established in 1991 to encourage reconstruction and development in Eastern and Central European countries, the London-based *European Bank for Reconstruction and Development* is owned by 69 countries and two intergovernmental institutions (the European Union and the European Investment Bank). Its loans are geared toward developing market-oriented economies and promoting private enterprise.

3-6c The International Monetary Fund

The **International Monetary Fund (IMF)** is an international bank with 190 member nations that makes short-term loans to developing countries experiencing balance-of-payment deficits. This financing is contributed by member nations, and it must be

multilateral development bank (MDB) an internationally supported bank that provides loans to developing countries to help them grow

World Bank a cooperative banking institution with 189 member countries

International Monetary Fund (IMF) an international bank that makes short-term loans to developing countries experiencing balance-of-payment deficits repaid with interest. Loans are provided primarily to fund international trade. Created in 1945 and headquartered in Washington, DC, the bank's main goals are to:

- promote international monetary cooperation
- facilitate the expansion and balanced growth of international trade
- promote exchange rate stability
- assist in establishing a multilateral system of payments, and
- make resources available to members experiencing balance-of-payment difficulties.

✓ Concept Check

- What is the Export-Import Bank of the United States? How does it assist U.S. exporters?
- What is a multilateral development bank (MDB)? Who supports these banks?
- What is the International Monetary Fund? What types of loans does the IMF provide?

Summary

3-1 Explain the economic bases for and importance of international business.

International business encompasses all business activities that involve exchanges across national boundaries. International trade is based on specialization, whereby each country produces the goods and services that it can produce more efficiently than any other goods and services. A nation is said to have an absolute or comparative advantage relative to these goods. International trade develops when each nation trades its surplus products for those in short supply.

International trade involves selling and shipping raw materials or products to other nations (exporting) and/or purchasing raw materials or products in other nations and bringing them into one's own country (importing). A nation's balance of trade is the difference between the value of its exports and the value of its imports. Its balance of payments is the difference between the flow of money into and out of the nation. Generally, a negative balance of trade is considered unfavorable. The United States has largely positive and growing trade relationships with most countries around the world.

3-2 Explore the methods by which a firm can organize for and enter into international markets.

A firm can enter international markets in several ways that require varying degrees of involvement, investment, and risk. It may export its products and sell them through foreign intermediaries or its own sales organization abroad, or it may sell its exports outright to an export-import merchant. It may license or franchise a foreign firm to produce and market its products. It may outsource or contract an overseas firm to manufacture its products, or it may enter into a joint venture or strategic alliance with a foreign firm. It may establish its own foreign subsidiaries, or it may develop into a multinational corporation.

Generally, each of these methods represents an increasingly deeper level of involvement in international business, with exporting being the simplest and the development of a multinational corporation the most involved.

3-3 Discuss the challenges businesses face when entering international markets, especially the restrictions nations place on international trade.

Despite the benefits of world trade, nations tend to use tariffs and nontariff barriers (import quotas, embargoes, and other restrictions) to limit trade. Tariffs—taxes levied on products entering a country—may be imposed to generate revenue or to protect domestic industries from foreign competition. These restrictions typically are justified as being needed to protect a nation's economy, industries, citizens, or security. They can result in the loss of jobs, higher prices, fewer choices in the marketplace, and the misallocation of resources. Businesspeople must recognize that there are differences in countries' standards of living, individual income and buying power, national resources, and infrastructure. The laws, regulatory agencies, political systems, and special-interest groups within a country all have a great impact on international business. Differences due to religious institutions, values, customs, social systems, and language can affect communications, negotiations, and perceptions of products and companies.

3-4 Identify the facilitators of international trade, including international trade agreements and international economic organizations working to foster trade.

The General Agreement on Tariffs and Trade (GATT) was formed to dismantle trade barriers and provide an environment in which international business can grow. Today, the World Trade Organization (WTO) and various economic communities carry on this mission. Among the most significant of these world economic communities are the European Union, the United States-Mexico-Canada Agreement, the Dominican Republic-Central America Free Trade Agreement, the Association of Southeast Asian Nations, the Commonwealth of Independent States, Comprehensive and Progressive Agreement for Trans-Pacific Partnership, and the Common Market of the Southern Cone.

3-5 Describe sources of export assistance.

Many government and international agencies provide export assistance to U.S. and foreign firms. Some of the most important sources of export assistance include the International Trade Administration, the Small Business Administration, and other governmental and international agencies.

3-6 Identify institutions that can help businesses and nations finance international business.

The financing of international trade is more complex than that of domestic trade. Institutions such as the Ex-Im Bank and the International Monetary Fund have been established to provide financing and ultimately to increase world trade for American and international firms.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

international business (69)
absolute advantage (69)
comparative advantage (70)
exporting (70)
importing (70)
balance of trade (70)
trade deficit (71)
balance of payments (73)
trading company (78)
countertrade 78)
licensing (78)
contract manufacturing (79)
outsourcing (79)
strategic alliance (79)
multinational corporation (80)
tariff (81)
dumping (82)
nontariff barrier (82)
import quota (82)
embargo (82)
exchange control (82)
currency devaluation (82)
General Agreement on Tariffs and Trade (GATT) (86)
World Trade Organization (WTO) (86)
economic community (86)
Export-Import Bank of the United States (90)
multilateral development bank (MDB) (91)
World Bank (91)
International Monetary Fund (IMF) (91)

Discussion Questions

1. When should a firm consider expanding from strictly domestic trade to international trade? When should it consider becoming further involved in international trade? What factors might affect the firm's decisions in each case?
2. Some politicians think tariffs will reduce their countries' trade deficits. Are they correct?
3. What effects might the devaluation of a nation's currency have on its business firms, its consumers, and the debts it owes to other nations?
4. Should imports to the United States be curtailed, by 20 percent or so, to eliminate our trade deficit? What might happen if this were done?
5. When the U.S. dollar is strong relative to other nations' currencies, what is the effect on imports and exports?
6. How can another country's cultural and political climate influence a firm's efforts to export there?
7. The United States restricts imports but, at the same time, supports the WTO and international banks whose objective is to enhance world trade. As a member of Congress, how would you justify this contradiction to your constituents?
8. How can a firm obtain the expertise needed to produce and market its products in another part of the world, for example, the EU?

Case 3

Honda's Strategy Is Electrifying

Honda Motor Company, a Japan-based multinational and the world's largest motorcycle manufacturer, was founded by Soichiro Honda in 1937. Honda, a Japanese engineer and innovator, built Honda Motor Company from the ground up. The automotive manufacturer, which started with 12 employees retrofitting bicycles with engines, has grown to more than 218,000 employees producing 19 million motorcycles, nearly 5 million automobiles, and more than 5 million power products every year. Today, Honda continues to innovate as the automotive market accelerates its transition to electric and hybrid technology.

Soichiro Honda always had an interest in vehicles. He founded Tokai Seiki (Eastern Sea Precision Machine Company) to make piston rings. Though he won a contract with Toyota, he lost the contract when it became evident that quality was lacking. He visited Toyota factories across Japan to learn more about quality control and perfect his product. Eventually, he created acceptable pistons using an automated process that could employ unskilled war-time laborers. At the start of World War II, Tokai Seiki was placed under the control of the Ministry of Commerce and Industry, and Honda was demoted at his own company. After the war, Honda sold what remained of Tokai Seiki to Toyota and used the profits to open the Honda Technical Research Institute.

With just a dozen employees in 1946, the company built and sold motorized bicycles using the former Imperial Army's generator engines. Demand was high, and the Honda Technical Research Institute soon ran out of stock. The company set out to make its own engine. Honda liquidated his business and used the money to incorporate Honda Motor Company. Its first complete motorcycle, the Honda 1949 D-Type, was just the start. The company grew to become the largest manufacturer of motorcycles by 1964.

In 1959, Honda Motor Company expanded into North America, opening its first overseas subsidiary in Los Angeles. Around this time, Honda opened Honda R&D Co., Ltd. to independently focus on research and development. Over the next several decades, Honda Motor Company continued to expand its product lines as well as operations and exports, opening its first overseas production facility in Belgium and becoming the first Japanese car manufacturer to open a production facility in the United States. Honda is now a household name with a reputation for producing quality cars and motorcycles.

Though Honda Motor Company is the world's largest manufacturer of internal combustion engines, it has had its sights set on new mobility for decades. In 2002, the company offered customers in the United States and Japan the Honda FCX, a fuel-cell powered car. Regulatory change and shifting consumer behavior in Europe have accelerated Honda's long-term electrification plans for the region, a strategy the company calls "Electric Vision." These changes have pushed Honda to introduce electrified powertrains for all of its European mainstream models several years ahead of schedule. Additionally, the company's advanced two-motor hybrid technology seen in the Honda Jazz hatchback and CR-V Hybrid has been met with acclaim across Europe. In a traditional hybrid model, an electric motor assists the car's engine, but in the Jazz hybrid electric vehicle, an electric engine assists the motor.

In the United States, on the other hand, Honda has a long road ahead to an electric future. Honda phased out the Clarity EV, its only all-electric car in the U.S. market at the time, leaving its fuel-cell and plug-in hybrid models. Buyers were unimpressed with its 89-mile driving range. In contrast, both the Chevy Bolt EV and Tesla Model 3 travel around 240 miles. To focus on the next generation of products, Honda partnered with rival General Motors (GM) to create two new all-electric vehicles using GM's proprietary Ultium battery and hands-free driver-assist technology wrapped in Honda's design. Strategic alliances such as this allow companies to pool resources, combine scale and manufacturing efficiencies, and create a competitive advantage.

By 2030, the majority of Honda's cars will be electric, zero-emission vehicles. Though there is still much progress to be made in the United States, Honda is quickly bringing its Electric Vision strategy to life in Europe. Additionally, Honda stands to greatly benefit from its strategic partnership with GM. Honda Motor Company's long history and its reputation for quality show that Honda is a company that knows how to innovate and adapt.[33]

Questions

1. How did Honda Motor Company build its reputation for producing quality cars and motorcycles?
2. What are the advantages of Honda's strategic alliance with GM?
3. How is Honda adapting to regulatory change and shifting consumer behavior in Europe?

Building Skills for Career Success

1. Social Media Exercise

Although Nike was founded in the Pacific Northwest and still has its corporate headquarters near Beaverton, Oregon, the company has become a multinational enterprise. The firm employs more than 75,000 people across six continents and is now a global marketer of footwear, apparel, and athletic equipment.

Because it operates in more than 170 countries around the globe and manufactures products in more than 500 factories in 39 different countries, sustainability is a big initiative for Nike. Today, Nike uses the YouTube social media site to share its sustainability message with consumers, employees, investors, politicians, and other interested stakeholders. To learn about the company's efforts to sustain the planet, follow these steps:

- Go to YouTube (www.youtube.com).
- Enter the words "Nike" and "Sustainability" in the search window and click the search button.

1. View at least three different YouTube videos about Nike's sustainability efforts.
2. Based on the information in the videos you watched, do you believe that Nike is a good corporate citizen because of its efforts to sustain the planet? Why or why not?
3. Prepare a one- to two-page report that describes how Nike is taking steps to reduce waste, improve the environment, and reduce its carbon footprint while manufacturing products around the globe.

2. Building Team Skills

The United States-Mexico-Canada Agreement (USMCA), which replaced the North American Free Trade Agreement (NAFTA), went into effect in 2020. It has made a difference in trade among the countries and has affected the lives of many people.

Assignment

1. Working in teams and using the resources of your library, investigate USMCA. Answer the following questions:
   a. What are USMCA's objectives?
   b. What are its benefits?
   c. What impact have NAFTA and USMCA had on trade, jobs, and travel?
   d. Some Americans were opposed to the implementation of NAFTA. What were their objections? Were any of these objections justified?
   e. Have NAFTA and USMCA influenced your life? How?
2. Summarize your answers in a written report. Your team also should be prepared to give a class presentation.

3. Researching Different Careers

Today, firms around the world need employees with special skills. In some countries, such employees are not always available, and firms then must search abroad for qualified applicants. One way they can do this is through global workforce databases. As business and trade operations continue to grow globally, you may one day find yourself working in a foreign country, perhaps for an American company doing business there or for a foreign company. In what foreign country would you like to work? What problems might you face?

Assignment

1. Choose a country in which you might like to work.
2. Research the country. The CIA's World Fact Book and the International Trade Administration are good places to start. Find answers to the following questions:
   a. What language is spoken in this country? Are you proficient in it? What would you need to do if you are not proficient?
   b. What are the economic, social, and legal systems like in this nation?
   c. What is its history?
   d. What are its culture and social traditions like? How might they affect your work or your living arrangements?
3. Describe what you have found out about this country in a written report. Include an assessment of whether you would want to work there and the problems you might face if you did.

Running a Business

Part 1

Let's Go Get a Graeter's!

Only a tiny fraction of family-owned businesses are still growing four generations and more than 150 years after their founding, but happily for lovers of premium-quality ice cream, Graeter's is one of them.

Now a nearly $125 million firm with national distribution, Graeter's was founded in Cincinnati in 1870 by Louis Charles Graeter and his wife, Regina Graeter. The young couple made ice cream and chocolate candies in the back room of their shop, sold them in the front room, and lived upstairs. Ice cream was a special treat in this era before refrigeration, and the Graeters started from scratch every day to make theirs from the freshest, finest ingredients. Even after freezers were invented, the Graeters continued to make ice cream in small batches to preserve the quality, texture, and rich flavor.

After her husband's death, Regina's entrepreneurial leadership became the driving force behind Graeter's expansion from 1920 until well into the 1950s. At a time when few women owned or operated a business, Regina opened 20 new Graeter's stores in the Cincinnati area and added manufacturing capacity to support this ambitious—and successful— growth strategy. Her sons and grandchildren followed her into the business and continued to open ice-cream shops all around Ohio and beyond. Today, three of Regina's great-grandsons run Graeter's with the same attention to quality that made the firm famous. In her honor, the street in front of the company's ultramodern Cincinnati factory is named Regina Graeter Way.

The Scoop on Graeter's Success

Graeter's fourth-generation owners are Richard Graeter II (CEO), Robert (Bob) Graeter (vice president of operations), and Chip Graeter (vice president of retail operations). They grew up in the business, learning through hands-on experience how to do everything from packing a pint of ice cream to locking up the store at night. They also absorbed the family's dedication to product quality, a key reason for the company's enduring success. "Our family has always been contented to make a little less profit in order to ensure our long-term survival," explains the CEO.

Throughout its history, Graeter's has used a unique, time-consuming manufacturing process to produce its signature ice creams in small batches. "Our competition is making thousands and thousands of gallons a day," says Chip Graeter. "We are making hundreds of gallons a day at the most. All of our ice cream is packed by hand, so it's a very laborious process." Graeter's "French pot" manufacturing method ensures that very little air gets into the product. As a result, the company's ice cream is dense and creamy, not light and fluffy—so dense, in fact, that each pint weighs nearly a pound.

Another success factor is the use of simple, fresh ingredients like high-grade chocolate, choice seasonal fruits, and farm-fresh cream. Graeter's imports some ingredients, such as vanilla from Madagascar, and buys other ingredients from U.S. producers known for their quality. "We use a really great grade of chocolate," says Bob Graeter. "We don't cut corners on that . . . Specially selected great black raspberries, strawberries, blueberries, and cherries go into our ice cream because we feel that we want to provide flavor not from artificial or unnatural ingredients but from really quality, ripe, rich fruits." Instead of tiny chocolate chips, Graeter's products contain giant chunks formed when liquid chocolate is poured into the ice-cream base just before the mixture is frozen and packed into pints.

Maintaining the Core of Success

Graeter's "fanatical devotion to product quality" and its time-tested recipes have not changed over the years. The current generation of owners is maintaining this core of the company's success while mixing in a generous dash of innovation. "If you just preserve the core," Bob Graeter says, "ultimately you stagnate. And if you are constantly stimulating progress and looking for new ideas, well, then you risk losing what was important. . . . Part of your secret to long-term success is knowing what your core is and holding to that. Once you know what you're really all about and what is most important to you, you can change everything else."

One of those "important" things is giving back to the community and its families via local charities and other initiatives. "Community involvement is just part of being a good corporate citizen," observes Richard Graeter. When Graeter's celebrated a recent new store opening, for example, it made a cash donation to the neighborhood public library. It is also a major sponsor of The Cure Starts Now Foundation, a research foundation seeking a cure for pediatric brain cancer. In line with its focus on natural goodness, Graeter's has been doing its part to preserve the environment by recycling and by boosting production efficiency to conserve water, energy, and other resources.

Graeter's Looks to the Future

Even though Graeter's recipes reflect its 19th-century heritage, the company is clearly a 21st-century operation. It has more than 200,000 Facebook "likes," connects with brand fans on Twitter and Instagram, and invites customers to subscribe to its email newsletter. The company sells its products online, shipping orders via United Parcel Service to ice-cream lovers across the continental United States. Its newly opened production facility uses state-of-the-art refrigeration, storage, and sanitation—yet the ice cream is still mixed by hand rather than by automated equipment. With an eye toward future growth, Graeter's is refining its information system to provide managers with all the details they need to make timely decisions in today's fast-paced business environment.

Graeter's competition ranges from small, local businesses to international giants such as Unilever, which owns Ben & Jerry's, and Froneri, which owns Haagen-Dazs. Throughout the economic ups and downs of recent years, Graeter's has continued to expand, and its ice creams are now distributed through 4,000 stores in 46 states. Oprah Winfrey and other celebrities have praised its products in public. But the owners are just as proud of their hometown success. "Graeter's in Cincinnati is synonymous with ice cream," says Bob Graeter. "People will say, 'Let's go get a Graeter's.'"[34]

Questions

1. How have Graeter's owners used the four factors of production to build the business over time?
2. Which of Graeter's stakeholders are most affected by the family's decision to take a long-term view of the business rather than aiming for short-term profit? Explain your answer.
3. Knowing that Graeter's competes with multinational corporations as well as small businesses, would you recommend that Graeter's expand by licensing its brand to a company in another country? Why or why not?

Building a Business Plan

Part 1

A *business plan* is a carefully constructed guide for a person starting a business. The purpose of a well-prepared business plan is to show how practical and attainable the entrepreneur's goals are. It also serves as a concise document that potential investors can examine to see if they would like to invest or assist in financing a new venture. A business plan should include the following 12 components:

- Introduction
- Executive summary
- Benefits to the community
- Company and industry
- Management team
- Manufacturing and operations plan
- Labor force
- Marketing plan
- Financial plan
- Exit strategy
- Critical risks and assumptions
- Appendix

A brief description of each of these sections is provided in Chapter 5. This is the first of seven exercises that appear at the ends of each of the seven major parts in this textbook. The goal of these exercises is to help you work through the preceding components to create your own business plan. In the exercise for this part, you will make decisions and complete the research that will help you develop the introduction for your business plan and the benefits to the community that your business will provide. In the exercises for Parts 2 through 6, you will add more components to your plan and eventually build a plan that actually could be used to start a business. The flowchart shown in Figure 3-5 gives an overview of the steps you will be taking to prepare your business plan.

The First Step: Choosing Your Business

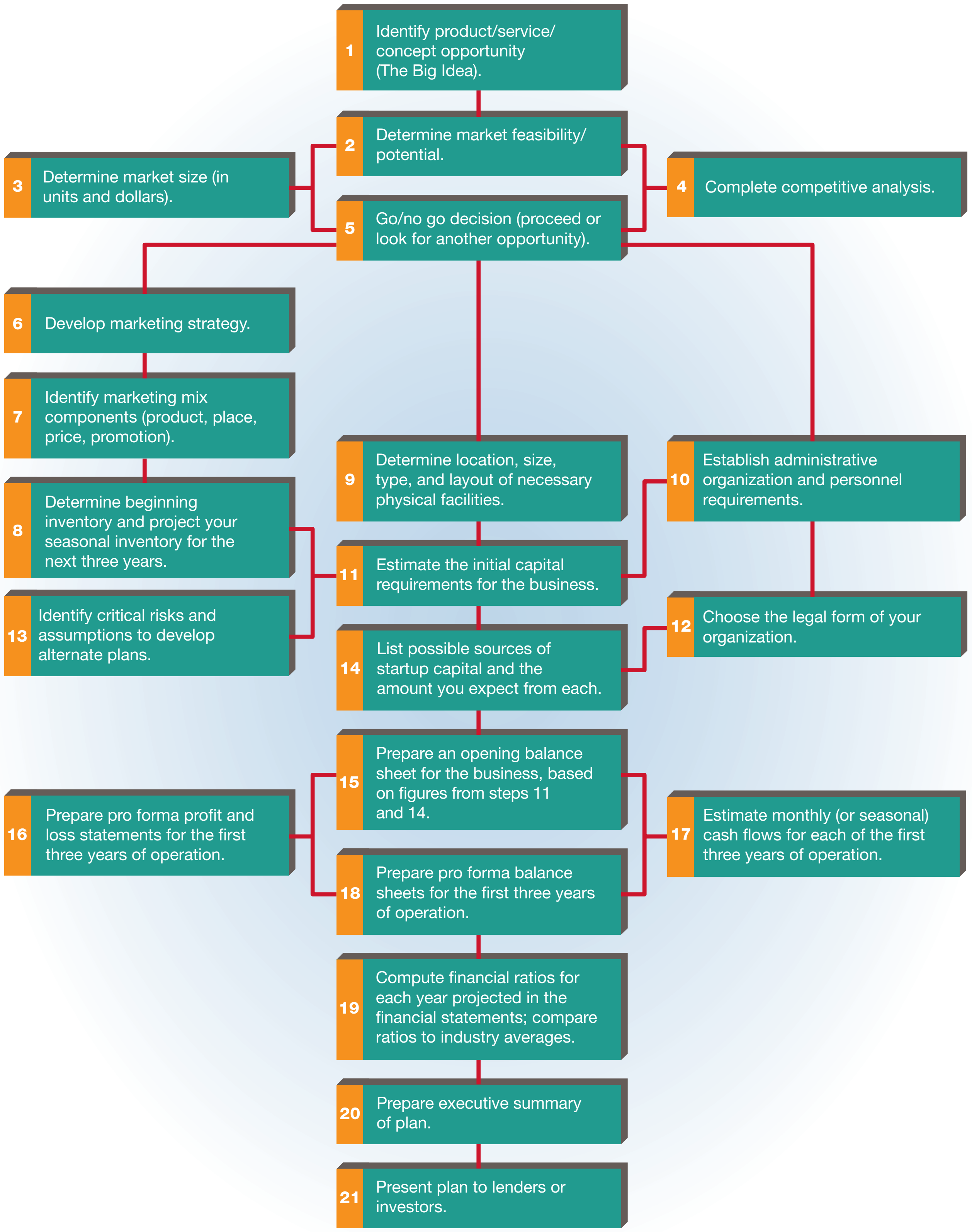
One of the first steps for starting your own business is to decide what type of business you want to start. Take some time to think about this decision. Before proceeding, answer the following questions:

- Why did you choose this type of business?
- Why do you think this business will be successful?
- Would you enjoy owning and operating this type of business?

Warning: Do not rush this step. This step often requires much thought, but it is well worth the time and effort. As an added bonus, you are more likely to develop a quality business plan if you really want to open this type of business.

Now that you have decided on a specific type of business, it is time to begin the planning process. The goal for this part is to complete the introduction and benefits-to-the-community components of your business plan.

Figure 3-5 Business Plan


1 Identify product/service/concept opportunity (The Big Idea).
2 Determine market feasibility/potential.
3 Determine market size (in units and dollars).
4 Complete competitive analysis.
5 Go/no go decision (proceed or look for another opportunity).
6 Develop marketing strategy.
7 Identify marketing mix components (product, place, price, promotion).
8 Determine beginning inventory and project your seasonal inventory for the next three years.
9 Determine location, size, type, and layout of necessary physical facilities.
10 Establish administrative organization and personnel requirements.
11 Estimate the initial capital requirements for the business.
12 Choose the legal form of your organization.
13 Identify critical risks and assumptions to develop alternate plans.
14 List possible sources of startup capital and the amount you expect from each.
15 Prepare an opening balance sheet for the business, based on figures from steps 11 and 14.
16 Prepare pro forma profit and loss statements for the first three years of operation.
17 Estimate monthly (or seasonal) cash flows for each of the first three years of operation.
18 Prepare pro forma balance sheets for the first three years of operation.
19 Compute financial ratios for each year projected in the financial statements; compare ratios to industry averages.
20 Prepare executive summary of plan.
21 Present plan to lenders or investors.

Source: Hatten, Timothy, *Small Business Management*, Fifth Edition. Copyright 2012 Cengage Learning.

Before you begin, it is important to note that the business plan is not a document that is written and then set aside. It is a living document that an entrepreneur should refer to continuously in order to ensure that plans are being carried through appropriately. As entrepreneurs begin to execute the plan, they should monitor the business environment continuously and make changes to the plan to address any challenges or opportunities that were not foreseen originally.

Throughout this course, you will, of course, be building your knowledge about business. Therefore, it will be appropriate for you to continually revisit parts of the plan that you have already written in order to refine them based on your more comprehensive knowledge. You will find that writing your plan is not a simple matter of starting at the beginning and moving chronologically through to the end. Instead, you probably will find yourself jumping around the various components, making refinements as you go. In fact, the second component—the executive summary—should be written last, but because of its comprehensive nature and its importance to potential investors, it appears after the introduction in the final business plan. By the end of this course, you should be able to put the finishing touches on your plan, making sure that all the parts create a comprehensive and sound whole so that you can present it for evaluation.

The Introduction Component

1.1. Start with the cover page. Provide the business name, street address, telephone number, Web address (if any), name(s) of owner(s) of the business, and the date the plan is issued.

1.2. Next, provide background information on the company and include the general nature of the business: retailing, manufacturing, or service; what your product or service is; what is unique about it; and why you believe that your business will be successful.

1.3. Then include a summary statement of the business's financial needs, if any. You probably will need to revise your financial needs summary after you complete a detailed financial plan later in Part 6.

1.4. Finally, include a statement of confidentiality to keep important information away from potential competitors.

The Benefits-to-the-Community Component

In this section, describe the potential benefits to the community that your business could provide. Chapter 2 in your textbook, "Ethics and Social Responsibility in Business," can help you in answering some of these questions. At the very least, address the following issues:

1.5. Describe the number of skilled and nonskilled jobs the business will create, and indicate how purchases of supplies and other materials can help local businesses.

1.6. Next, describe how providing needed goods or services will improve the community and its standard of living.

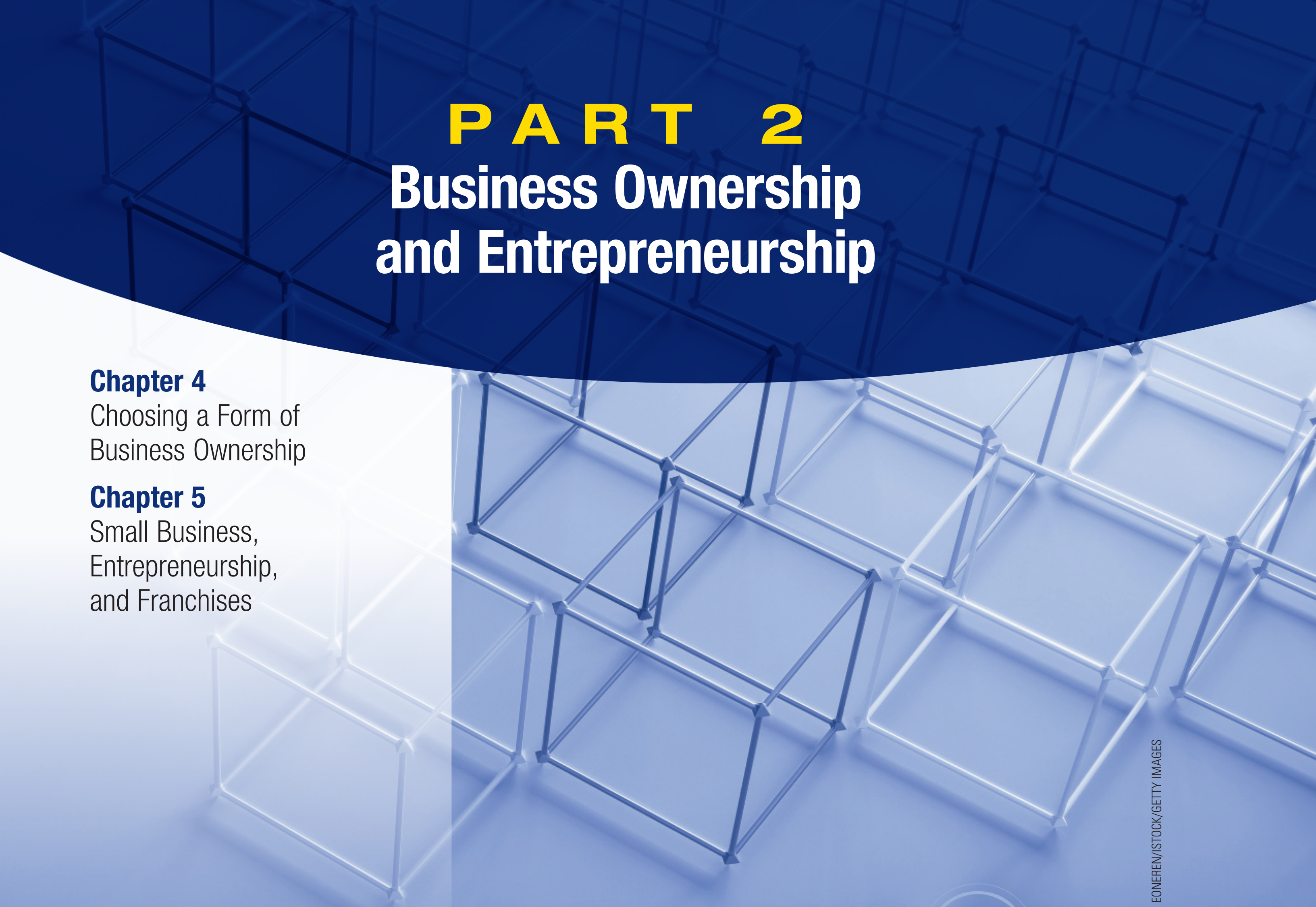
1.7. Finally, state how your business can offer attractive wages; develop new technical, management, or leadership skills; and provide other types of individual growth.

Review of Business Plan Activities

Read over the information that you have gathered. Because the Building a Business Plan exercises at the end of Parts 2 through 6 are built on the work you do in Part 1, make sure that any weaknesses or problem areas are resolved before continuing. Finally, write a brief statement that summarizes all the information for this part of the business plan.

PART 2

Business Ownership and Entrepreneurship



EONEREN/ISTOCK/GETTY IMAGES

Chapter 4
Choosing a Form of Business Ownership

Chapter 5
Small Business, Entrepreneurship, and Franchises

IPOPBA/ISTOCK/GETTY IMAGES

In this part, we examine two very practical aspects of business: The most popular (and most important) forms of legal ownership business owners choose. In addition, because the majority of businesses are small, we look at specific issues related to small business.

Chapter

4

Grand Opening

RAWPIXEL.COM/SHUTTERSTOCK.COM

Choosing a Form of Business Ownership

Learning Objectives

Once you complete this chapter, you will be able to:

4-1 Describe the advantages and disadvantages of sole proprietorships.

4-2 Explain the different types of partners and the importance of partnership agreements.

4-3 Describe the advantages and disadvantages of partnerships.

4-4 Summarize how a corporation is formed.

4-5 Describe the advantages and disadvantages of a corporation.

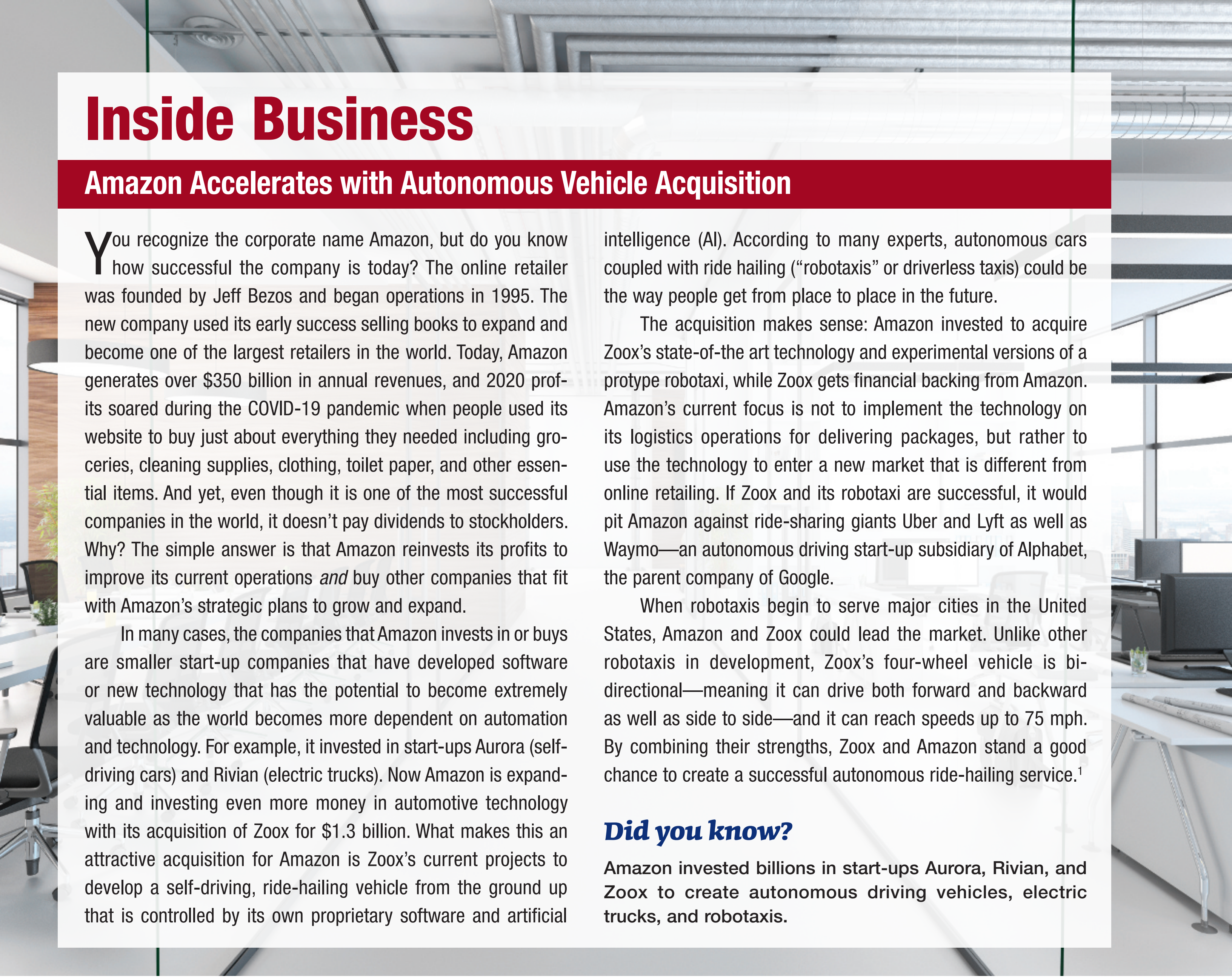
4-6 Examine special types of businesses, including S corporations, limited liability companies, and not-for-profit corporations.

4-7 Discuss the purpose of a joint venture and syndicate.

4-8 Explain how growth from within and growth through mergers can enable a business to expand.

Why Should You Care?

There's a good chance that during your lifetime you will work for a business or start a business. With this fact in mind, the material in this chapter can help you understand how and why businesses are organized.



Inside Business

Amazon Accelerates with Autonomous Vehicle Acquisition

You recognize the corporate name Amazon, but do you know how successful the company is today? The online retailer was founded by Jeff Bezos and began operations in 1995. The new company used its early success selling books to expand and become one of the largest retailers in the world. Today, Amazon generates over $350 billion in annual revenues, and 2020 profits soared during the COVID-19 pandemic when people used its website to buy just about everything they needed including groceries, cleaning supplies, clothing, toilet paper, and other essential items. And yet, even though it is one of the most successful companies in the world, it doesn't pay dividends to stockholders. Why? The simple answer is that Amazon reinvests its profits to improve its current operations *and* buy other companies that fit with Amazon's strategic plans to grow and expand.

In many cases, the companies that Amazon invests in or buys are smaller start-up companies that have developed software or new technology that has the potential to become extremely valuable as the world becomes more dependent on automation and technology. For example, it invested in start-ups Aurora (self-driving cars) and Rivian (electric trucks). Now Amazon is expanding and investing even more money in automotive technology with its acquisition of Zoox for $1.3 billion. What makes this an attractive acquisition for Amazon is Zoox's current projects to develop a self-driving, ride-hailing vehicle from the ground up that is controlled by its own proprietary software and artificial intelligence (AI). According to many experts, autonomous cars coupled with ride hailing ("robotaxis" or driverless taxis) could be the way people get from place to place in the future.

The acquisition makes sense: Amazon invested to acquire Zoox's state-of-the art technology and experimental versions of a protype robotaxi, while Zoox gets financial backing from Amazon. Amazon's current focus is not to implement the technology on its logistics operations for delivering packages, but rather to use the technology to enter a new market that is different from online retailing. If Zoox and its robotaxi are successful, it would pit Amazon against ride-sharing giants Uber and Lyft as well as Waymo—an autonomous driving start-up subsidiary of Alphabet, the parent company of Google.

When robotaxis begin to serve major cities in the United States, Amazon and Zoox could lead the market. Unlike other robotaxis in development, Zoox's four-wheel vehicle is bi-directional—meaning it can drive both forward and backward as well as side to side—and it can reach speeds up to 75 mph. By combining their strengths, Zoox and Amazon stand a good chance to create a successful autonomous ride-hailing service.[1]

Did you know?

Amazon invested billions in start-ups Aurora, Rivian, and Zoox to create autonomous driving vehicles, electric trucks, and robotaxis.

Just for a moment, think about how business was defined in Chapter 1.

> *"Business is the organized effort of individuals to produce and sell for a profit, the goods and services that satisfy society's needs."*

A company like Amazon must make many decisions in order to grow and expand. While most people have bought something online using Amazon, the company wasn't always a large, successful company. For Jeff Bezos and the people who started Amazon, one of the most important decisions they had to make was choosing a form of ownership. Options included sole proprietorship, partnership, corporation, or special forms of ownership that will meet a company's special needs. Amazon chose the corporate form of ownership because it provided a number of advantages compared to other forms of business ownership.

We begin this chapter by describing the three common forms of business ownership: sole proprietorships, partnerships, and corporations. We discuss how these types of businesses are formed and note the advantages and disadvantages of each. Next, we consider several types of business ownership usually chosen for special purposes, including S corporations, limited liability companies (LLCs), not-for-profit corporations, joint ventures, and syndicates. We conclude the chapter with a discussion of how businesses can grow through internal expansion or through mergers with other companies.

4-1 Sole Proprietorships

Learning Objective

4-1 Describe the advantages and disadvantages of sole proprietorships.

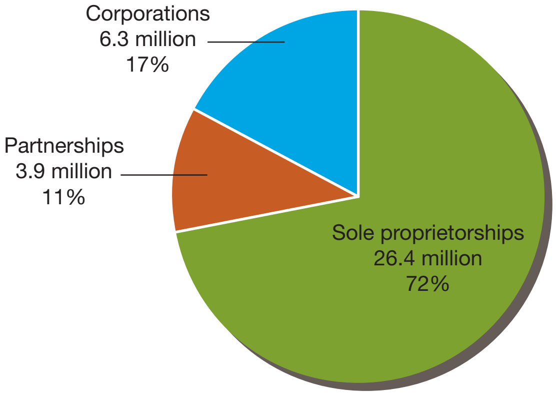
A **sole proprietorship** is a business that is owned (and usually operated) by one person. Although a few sole proprietorships are large and have many employees, most are small. Some of today's largest corporations, including Walmart, JCPenney, and Procter & Gamble Company, started out as tiny—and in many cases, struggling—sole proprietorships.

Often entrepreneurs with a promising idea choose the sole proprietorship form of ownership. Way back in 1886, Samuel Curtis Johnson sold wood parquet flooring in Racine, Wisconsin. His business—a sole proprietorship—was successful selling floors, but he became much more successful selling floor wax—an idea he got after many customers asked what the best way was to protect their new parquet floor and at the same time maintain the shiny new look. Their questions inspired Mr. Johnson to create his first batch of floor wax. Some would say, why is this important? After all, this was 1886. Fast forward: Today, Mr. Johnson's small sole proprietorship business has grown and expanded to become a global company with annual revenues in excess of $10 billion and more than 13,000 employees. The SC Johnson Company still sells floor wax, but its product line now includes Windex glass cleaner, Pledge furniture polish, Ziploc food storage bags, Off insect repellant, Kiwi shoe polish, and many other consumer and professional products. See the Chapter 4 case at the end of the chapter for more about SC Johnson.[2]

Figure 4-1 shows that there are approximately 26.4 million sole proprietorships in the United States. They account for 72 percent of the country's business firms. Although the most popular form of ownership when compared with partnerships and corporations, they rank last in total sales revenues. As shown in Figure 4-2, sole proprietorships account for about $1.5 trillion, or about 4 percent of total annual sales.

Sole proprietorships are most common in retailing, service, and agriculture. Thus, the small, clothing boutique, appliance-repair shop down the street, and independent farmer are likely to be sole proprietorships.

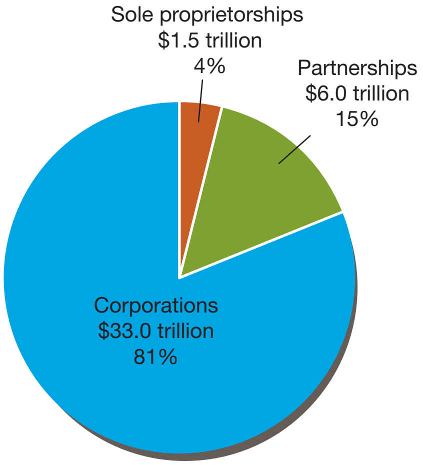
Figure 4-1 **Relative Percentages of Sole Proprietorships, Partnerships, and Corporations in the United States**



Source: "Statistics of Income," The Internal Revenue Service website at www.irs.gov (accessed January 4, 2021).

sole proprietorship a business that is owned (and usually operated) by one person

Figure 4-2 Total Sales Receipts of Sole Proprietorships, Partnerships, and Corporations in the United States



Source: "Statistics of Income," The Internal Revenue Service website at www.irs.gov (accessed January 4, 2021).

4-1a Advantages of Sole Proprietorships

Most of the advantages of sole proprietorships arise from the two main characteristics of this form of ownership: simplicity and individual control.

Ease of Start-Up and Closure Sole proprietorship is the simplest way to start a business. A sole proprietorship can be, and most often is, established without the services of an attorney. The legal requirements often are limited to registering the name of the business and obtaining any necessary licenses or permits.

If the enterprise does not succeed, the firm can be closed as easily as it was opened. Creditors must be paid, of course, but generally, the owner of a sole proprietorship does not have to go through any legal procedure before hanging up an "Out of Business" sign.

Pride of Ownership Successful sole proprietors are often very proud of their accomplishments—and rightfully so. In almost every case, the owner deserves a great deal of credit for solving the day-to-day problems associated with operating a sole proprietorship business. Unfortunately, the reverse is also true. When the business fails, it is often the sole proprietor who is to blame.

Retention of All Profits Because all profits become the personal earnings of the owner, the owner has a strong incentive to succeed. This direct financial reward attracts many entrepreneurs to the sole proprietorship form of business and, if the business succeeds, is a source of great satisfaction.

No Special Taxes Profits earned by a sole proprietorship are taxed as the personal income of the owner. As a result, a sole proprietor must report business profit or loss and certain other financial information for a business on the Internal Revenue Service's Schedule C, which becomes part of their personal income tax return. They must also make estimated quarterly tax payments to the federal government.

Flexibility of Being Your Own Boss Sole proprietors are completely free to make decisions about the firm's operations. Without asking or waiting for anyone's approval, sole proprietors can move a shop's location, open a new store, or close an old one. And they can make an immediate change in business hours. The manager of a store in a large corporate chain such as Best Buy Company may have to seek the approval of numerous managers and company officials before making such changes.

STORE
CLOSING
GOING
OUT OF
BUSINESS

CAROLYN FRANKS/SHUTTERSTOCK.COM

Going out of business hurts! There are many reasons why businesses—especially sole proprietors and partnerships—fail. Lack of money, poor management, bad location, poor product selection, and many other factors can cause a business to close the doors. Regardless of the reason, it always hurts those who have invested their time, money, and effort to start a business.

4-1b Disadvantages of Sole Proprietorships

The disadvantages of a sole proprietorship stem from the fact that these businesses are owned by one person. Some capable sole proprietors experience no problems. Individuals who start out with few management skills and little money are most at risk for failure.

Unlimited Liability **Unlimited liability** is a legal concept that holds a business owner personally responsible for all the debts of the business. There is legally no difference between the debts of the business and the debts of the proprietor. If the business fails, or if the business is involved in a lawsuit and loses, the owner's personal property—including savings and other assets—can be seized (and sold if necessary) to pay creditors.

Unlimited liability is perhaps the major factor that tends to discourage would-be entrepreneurs with substantial personal wealth from using the sole proprietor form of business organization. Unlimited liability is also a reason why many sole proprietors switch to the corporate form of ownership or some other type of business organization that limits their personal liability once their businesses become successful.

Lack of Continuity Legally, the sole proprietor *is* the business. If the owner retires, is declared legally incompetent, or dies, the business essentially ceases to exist. In many cases, however—especially when the business is a profitable enterprise—the owner may sell the business or the owner's heirs may take it over and either sell it or continue to operate it. The business also can suffer if the sole proprietor becomes ill and cannot work for an extended period of time. If the owner, for example, has a heart attack, there is often no one who can step in and manage the business. An illness can be devastating if the sole proprietor's personal skills are what determine if the business is a success or a failure.

Lack of Money Banks, suppliers, and other lenders usually are unwilling to lend large sums of money to sole proprietorships. Only one person—the sole proprietor—can be held responsible for repaying such loans, and the assets of most sole proprietors usually are limited. Moreover, these assets may have been used already as security or collateral for personal borrowing (a home mortgage or car loan) or for short-term credit from suppliers. Lenders also worry about the lack of continuity of sole proprietorships: Who will repay a loan if the sole proprietor dies?

unlimited liability a legal concept that holds a business owner personally responsible for all the debts of the business

Finally, many lenders are concerned about the large number of sole proprietorships that fail—a topic discussed in Chapter 5.

The limited ability to borrow money can prevent a sole proprietorship from growing. It is the main reason that many business owners, when in need of relatively large amounts of capital, change from a sole proprietorship to a partnership or the corporate form of ownership.

Limited Management Skills The sole proprietor is often the sole manager—in addition to being the only salesperson, buyer, accountant, and, on occasion, janitor. Even the most experienced business owners are unlikely to have expertise in all these areas. Unless they obtain the necessary expertise by hiring employees, assistants, or consultants, the business can suffer in the areas in which the owner is less knowledgeable. For the many sole proprietors who cannot afford to hire the help they need, there just are not enough hours in the day to do everything that needs to be done.

Difficulty in Hiring Employees The sole proprietor may find it hard to attract and keep competent help. Potential employees may feel that there is no room for advancement in a firm whose owner assumes all managerial responsibilities. And when those who *are* hired are ready to take on added responsibility, they may find that the only way to do so is to quit a sole proprietorship business and go to work for a larger firm or start their own business. The lure of higher salaries and increased benefits also may cause existing employees to change jobs.

4-1c Beyond the Sole Proprietorship

Like many others, you may decide that the major disadvantage of a sole proprietorship is the limited amount that one person can do in a workday. One way to reduce the effect of this disadvantage (and retain many of the advantages) is to form a partnership and have more than one owner.

✓ Concept Check

- What is a sole proprietorship?
- What are the advantages of a sole proprietorship?
- What are the disadvantages of a sole proprietorship?

Ethics and Social Responsibility

How American Express Helps Small Businesses

During the COVID-19 pandemic, one thing became clear: regular customers are necessary for small businesses to survive. Knowing this, American Express, the company that started Small Business Saturday—an initiative to encourage customers to shop at small businesses—committed more than $200 million to launch its largest global "shop small" campaign to date. In addition, the credit card company pledged $10 million to support Black-owned small businesses during the pandemic.

According to research conducted by American Express, many small businesses were in danger of failing. As many as 25 percent of small business owners stopped paying themselves a salary during the pandemic in order to remain open. The research data also showed having regular customers return would help small businesses recover and at the same time help local communities. For this reason, American Express developed a program to provide incentives to encourage customers to shop small. The credit card company offered customers $5 back if they spent $10 or more at eligible small businesses, an offer that could be redeemed up to ten times.

It's important for small businesses to survive and grow because they bring value to their communities beyond the goods and services they sell. According to American Express, for every dollar spent at small businesses, $0.67 stays in the local community. American Express's long-running history of supporting "shop small" campaigns and small business owners demonstrates that it views small businesses as the lifeblood of the U.S. economy.

Sources: Based on information in Alexandra Pastore, "American Express Launches Its Largest Global Shop Small Campaign," *WWD*, June 29, 2020, www.wwd.com/business-news/business-features/american-express-launches-its-largest-global-shop-small-campaign-1203662381/; Daily Flash TV, "American Express Help Small Business | Walter Frye | DailyFlashTV," *YouTube*, July 5, 2020, https://www.youtube.com/watch?v=0g1uwq0rmto; Robert Hackett, "AmEx Will Give You up to $50 If You Shop at Small Businesses," *Fortune*, June 29, 2020, www.fortune.com/2020/06/29/american-express-amex-shop-small-businesses-50-dollar-reward/.

4-2 Partnerships

Learning Objective

4-2 Explain the different types of partners and the importance of partnership agreements.

A person who would not think of starting and running a sole proprietorship business alone may enthusiastically seize the opportunity to form a business partnership. The U.S. Uniform Partnership Act defines a **partnership** as a voluntary association of two or more persons to act as co-owners of a business for profit. Way back in 1837, William Procter and James Gamble—two sole proprietors—formed a partnership called Procter & Gamble (P&G). Their partnership combined the talents of each man and helped the new partnership business compete with 14 other soap and candle makers in Cincinnati, Ohio. Eventually, in 1890, P&G incorporated to raise additional capital for expansion that allowed the company to become a global giant. Today, P&G brands are known worldwide and include Pantene, Gillette, Tide, Crest, and many more that people use every day.[3]

As shown in Figures 4-1 and 4-2, there are approximately 3.9 million partnerships in the United States, and this type of ownership accounts for about $6 trillion in sales receipts each year. Note, however, that this form of ownership is much less common than the sole proprietorship or the corporation. In fact, as shown in Figure 4-1, partnerships represent only about 11 percent of all American businesses. Although there is no legal maximum on the number of partners a partnership may have, most have only two. Regardless of the number of people involved, a partnership often represents a pooling of special managerial skills and talents; at other times, it is the result of a sole proprietor taking on a partner for the purpose of obtaining more capital.

4-2a Types of Partners

All partners are not necessarily equal. Some may be active in running the business, whereas others may have a limited role.

General Partners A **general partner** is a person who assumes full or shared responsibility for operating a business. General partners are active in day-to-day business operations, and each partner can enter into contracts on behalf of the other partners. They also assume unlimited liability for all debts, including business debts incurred by any other general partner without their knowledge or consent. To avoid future liability, a general partner who withdraws from the partnership must give notice to creditors, customers, and suppliers.

ally
assist
share
help
Partner
sustain
support
cooperate
collaborate
participate

DUSIT/SHUTTERSTOCK.COM

Limited Partners A **limited partner** is a person who invests money in a business but who has no management responsibility or liability for losses beyond their investment in the partnership. Typically, the general partner or partners collect management fees and receive a percentage of profits. Limited partners receive a portion of profits and tax benefits. Limited partnerships, for example, may be formed to finance real estate, oil and gas, motion picture, and other business ventures.

Because of potential liability problems, special rules apply to limited partnerships. These rules are intended to protect customers and creditors who deal with limited partnerships. For example, prospective partners in a limited partnership must file a formal declaration, usually with the secretary of state, that describes the essential details of the partnership and the liability status of each partner involved in the business. At least one general partner must be responsible for the debts of the limited partnership. Also, some states require the name of a limited partnership to include the term "limited partnership" or the abbreviation "LP."

partnership a voluntary association of two or more persons to act as co-owners of a business for profit

general partner a person who assumes full or shared responsibility for operating a business

limited partner a person who invests money in a business but has no management responsibility or liability for losses beyond the amount they invested in the partnership

4-2b **The Partnership Agreement**

Articles of partnership refers to an agreement listing and explaining the terms of the partnership. Although both oral and written partnership agreements are legal and can be enforced in the courts, a written agreement has an obvious advantage. It is not subject to lapses of memory. Although the people involved in a partnership can draft their own agreement, most experts recommend consulting an attorney. Figure 4-3 shows a typical partnership agreement. The partnership agreement should state:

- The names of the people involved and the address of the business;
- What the nature of the business is;
- What each partner's duties will be;
- The investment each partner will make;
- How much salary each partner receives and how profits or losses will be divided; and
- What happens if a partner wants to dissolve the partnership or dies.

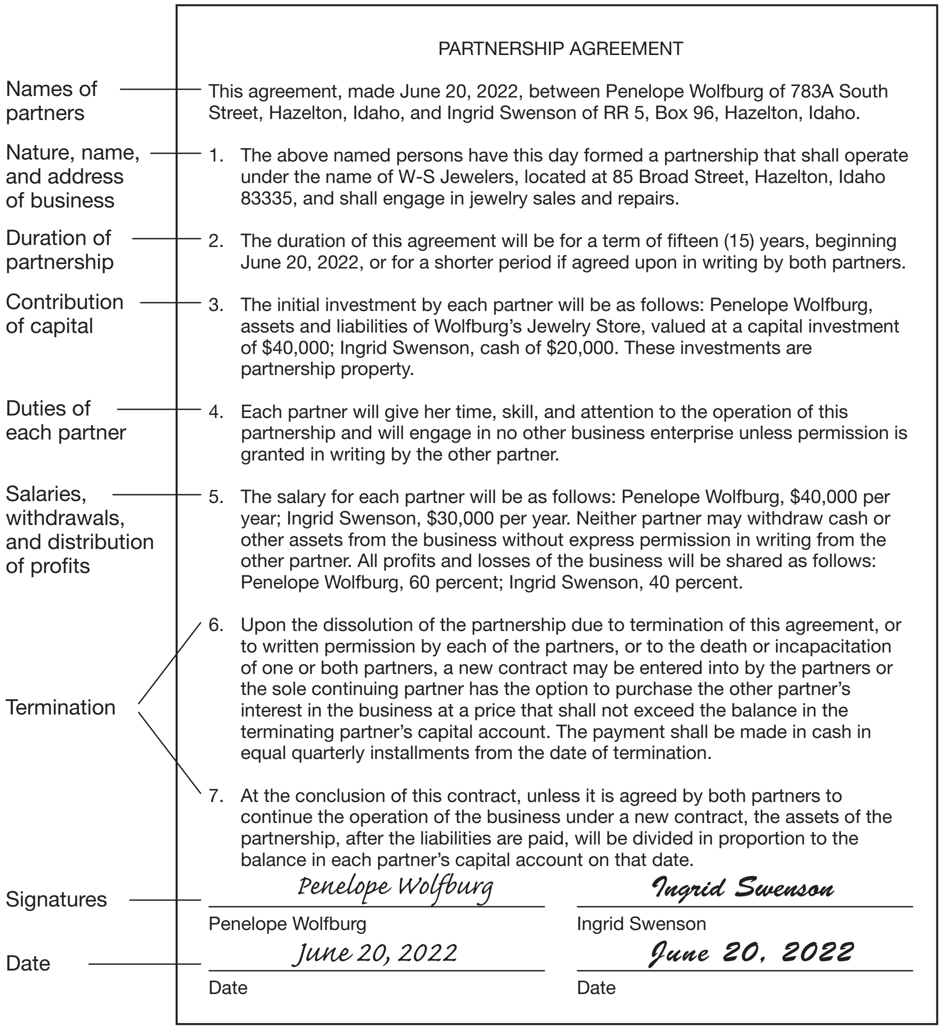
When entering into a partnership agreement, partners would be wise to let a neutral third party—a consultant, an accountant, a lawyer, or a mutual friend—assist with any disputes that might arise.

✓ Concept Check

- How does a sole proprietorship differ from a partnership?
- Explain the difference between a general partner and a limited partner.
- Describe the issues that should be included in a partnership agreement.

Figure 4-3 **Articles of Partnership**

The articles of partnership is a written or oral agreement that lists and explains the terms of a partnership.



Names of partners
Nature, name, and address of business
Duration of partnership
Contribution of capital
Duties of each partner
Salaries, withdrawals, and distribution of profits
Termination
Signatures
Date

PARTNERSHIP AGREEMENT

This agreement, made June 20, 2022, between Penelope Wolfburg of 783A South Street, Hazelton, Idaho, and Ingrid Swenson of RR 5, Box 96, Hazelton, Idaho.

1. The above named persons have this day formed a partnership that shall operate under the name of W-S Jewelers, located at 85 Broad Street, Hazelton, Idaho 83335, and shall engage in jewelry sales and repairs.
2. The duration of this agreement will be for a term of fifteen (15) years, beginning June 20, 2022, or for a shorter period if agreed upon in writing by both partners.
3. The initial investment by each partner will be as follows: Penelope Wolfburg, assets and liabilities of Wolfburg's Jewelry Store, valued at a capital investment of $40,000; Ingrid Swenson, cash of $20,000. These investments are partnership property.
4. Each partner will give her time, skill, and attention to the operation of this partnership and will engage in no other business enterprise unless permission is granted in writing by the other partner.
5. The salary for each partner will be as follows: Penelope Wolfburg, $40,000 per year; Ingrid Swenson, $30,000 per year. Neither partner may withdraw cash or other assets from the business without express permission in writing from the other partner. All profits and losses of the business will be shared as follows: Penelope Wolfburg, 60 percent; Ingrid Swenson, 40 percent.
6. Upon the dissolution of the partnership due to termination of this agreement, or to written permission by each of the partners, or to the death or incapacitation of one or both partners, a new contract may be entered into by the partners or the sole continuing partner has the option to purchase the other partner's interest in the business at a price that shall not exceed the balance in the terminating partner's capital account. The payment shall be made in cash in equal quarterly installments from the date of termination.
7. At the conclusion of this contract, unless it is agreed by both partners to continue the operation of the business under a new contract, the assets of the partnership, after the liabilities are paid, will be divided in proportion to the balance in each partner's capital account on that date.

Penelope Wolfburg	Ingrid Swenson
Penelope Wolfburg	Ingrid Swenson
June 20, 2022	June 20, 2022
Date	Date

Source: Adapted from Goldman and Sigismond, *Cengage Advantage Books: Business Law 9E.*

4-3 Advantages and Disadvantages of Partnerships

Learning Objective

4-3 Describe the advantages and disadvantages of partnerships.

When compared to sole proprietorships and corporations, partnerships are the least popular form of business ownership. Still there are situations when forming a partnership makes perfect sense.

4-3a Advantages of Partnerships

Before you make a decision to form a partnership, all the people involved should consider both the advantages and disadvantages of a partnership. Partnerships have many advantages. The most important are described below.

Ease of Start-Up Partnerships are relatively easy to form. As with a sole proprietorship, the legal requirements often are limited to registering the name of the business and obtaining any necessary licenses or permits. It may not even be necessary to prepare written articles of partnership, although doing so is generally a good idea.

Availability of Capital and Credit Because partners can pool their funds, a partnership usually has more capital available than a sole proprietorship does. This additional capital, coupled with the general partners' unlimited liability and combined management skills, may encourage banks and suppliers to extend more credit or approve larger loans to a partnership than to a sole proprietor. Still, partnerships have found it hard to get long-term financing simply because lenders worry about the possibility of management disagreements and lack of continuity.

Personal Interest General partners are very concerned with the operation of the firm—perhaps even more so than sole proprietors. After all, they are responsible for the actions of all other general partners, as well as for their own. The pride of ownership from solving the day-to-day problems of operating a business—with the help of another person(s)—is a strong motivating force and often makes all the people involved in the partnership work harder to become more successful.

Combined Business Skills and Knowledge Partners often have complementary skills. The weakness of one partner—in manufacturing, for example—may be offset by another partner's strength in that area. Moreover, the ability to discuss important decisions with another concerned individual often relieves some pressure and leads to more effective decision making.

Retention of Profits As in a sole proprietorship, all profits belong to the owners of the partnership. The partners share directly in the financial rewards and therefore are highly motivated to do their best to make the firm succeed. As noted earlier, the partnership agreement should state how much profit or loss each partner receives or is responsible for.

No Special Taxes Although a partnership pays no income tax, the Internal Revenue Service requires partnerships to file an annual information return that states the receipts and expenses for the partnership and the amount of profit or loss. The partnership return must also list the names of all partners involved in the business and their share of the partnership's profit or loss. Then all partners are required to report their share of profit (or loss) from the partnership on their individual tax returns. Ultimately each partner's share of the partnership profit is taxed in the same way a sole proprietor is taxed.

When a business is successful, it's a great source of pride for the owners. Small business owners will tell you that it takes a lot of hard work to create a successful business. It also takes money, good management skills, the ability to overcome problems, and in some cases luck. And yet, when a business is successful, there's a great deal of pride in what they've accomplished.

OPEN
AM
CLOSE
18 PM
WELCOME
OPEN

TZIDO SUN/SHUTTERSTOCK.COM

4-3b Disadvantages of Partnerships

Although partnerships have many advantages when compared with sole proprietorships and corporations, they also have some disadvantages, which anyone thinking of forming a partnership should consider.

Unlimited Liability As we have noted, each *general* partner has unlimited liability for all debts of the business. Each partner is legally and personally responsible for the debts, taxes, and actions of any other partner conducting partnership business, even if that partner did not incur those debts or do anything wrong. General partners thus run the risk of having to use their personal assets to pay creditors. *Limited* partners, however, risk only their original investment.

Today, many states allow partners to form a *limited liability partnership* (LLP), in which a partner may have limited liability protection from legal action resulting from the malpractice or negligence of the other partners. Many states that allow LLPs restrict this type of ownership to certain types of professionals such as accountants, architects, attorneys, and similar professionals. (Note the difference between a limited partnership and an LLP. A limited partnership must have at least one general partner that has unlimited liability. On the other hand, all partners in an LLP may have limited liability *for the malpractice and negligence of the other partners*.)

Management Disagreements What happens to a partnership if one of the partners brings a spouse or a relative into the business? What happens if a partner wants to withdraw more money from the business? Notice that each of these situations—and for that matter, most of the other problems that can develop in a partnership—involves one partner doing something that disturbs the other partner(s). This human factor is especially important because business partners—with egos, ambitions, and money on the line—are especially susceptible to friction. When partners begin to disagree about decisions, policies, or ethics, distrust may build and get worse as time passes. In these situations, it may become impossible to operate the business successfully.

Lack of Continuity Partnerships are terminated if any one of the general partners withdraws from the business, is declared legally incompetent, or dies. However, the remaining partners can purchase that partner's ownership share. For example, the partnership agreement may permit surviving partners to continue the business after buying a deceased partner's interest from the estate. However, if the partnership loses an owner whose specific management or technical skills cannot be replaced, it is not likely to survive.

Frozen Investment It is easy to invest money in a partnership, but it is sometimes quite difficult to get it out. This is the case, for example, when remaining partners are unwilling to buy the share of the business that belongs to a partner who retires. To avoid such difficulties, the partnership agreement should include some procedure for buying out a partner.

In some cases, a partner must find someone outside the firm to buy their share. How easy or difficult it is to find an outsider depends on how successful the business is and how willing existing partners are to accept a new partner.

4-3c Beyond the Partnership

The main advantages of a partnership over a sole proprietorship are increased availability of capital and credit and the combined business skills and knowledge of the partners. However, some of the basic disadvantages of the sole proprietorship also plague the general partnership. A third form of business ownership, the corporation, overcomes many of these disadvantages.

✓ Concept Check

- What are the advantages of a partnership?
- What are the disadvantages of a partnership?

4-4 Corporations

Learning Objective

4-4 Summarize how a corporation is formed.

Recognize the name Ray Kroc? Maybe not the name, but there's a good chance you have purchased some fast food from McDonalds. Here's the story: Back in 1954, Ray Kroc was selling Multimixers malt machines when he met two brothers, Dick and Mac McDonald, who were running a fast-food restaurant that served burgers, fries, and beverages. The McDonald brothers were looking for an agent to help grow their business. Kroc saw an opportunity and founded the McDonald's System, Inc., a predecessor to today's McDonald's Corporation. Kroc's goal was to build a restaurant system that would be famous for providing food of consistently high quality that tasted the same in Alaska as it did in Alabama.

While Kroc and the executives of McDonald's had to make many decisions, one very important decision was to incorporate the business. While they could have chosen other forms of business ownership, the decision to incorporate enabled the company to attract investors and raise additional capital for expansion that eventually allowed it to become a global giant. Today, McDonald's has more than 38,000 locations in more than 100 countries around the globe.[4]

While not all sole proprietorships and partnerships become corporations, there are reasons why business owners choose the corporate form of ownership. Let's begin with a definition of a corporation. Perhaps the best definition of a corporation was given by Chief Justice John Marshall in a famous Supreme Court decision in 1819. A corporation, he said, "is an artificial person, invisible, intangible, and existing only in contemplation of the law." In other words, a **corporation** (sometimes referred to as a *regular* or a *C corporation*) is an artificial person, created by law, with most of the legal rights of a real person. These include:

- The right to start and operate a business.
- The right to buy or sell property.
- The right to borrow money.
- The right to sue or be sued.
- The right to enter into binding contracts.

corporation (sometimes referred to as a *regular* or a *C corporation*) an artificial person, created by law, with most of the legal rights of a real person

Unlike a real person, however, a corporation exists only on paper. There are approximately 6.3 million corporations in the United States. They comprise about 17 percent of all businesses, but they account for 81 percent of sales revenues (refer to Figures 4-1 and 4-2).

4-4a **Corporate Ownership**

The shares of ownership of a corporation are called **stock**. Once a corporation has been formed, it may sell its stock to individuals or other companies that want to invest in the corporation. It also may issue stock as a reward to key employees or as a return to investors in place of cash payments. The people who own a corporation's stock—and thus own part of the corporation—are called **stockholders**.

A **closed corporation** (sometimes referred to as a private corporation) is a corporation whose stock is owned by relatively few people and is not sold to the general public. As an example, Mars—the company famous for M&Ms, Snickers, Dove, Milky Way, Twix, and other food products—is a privately held, family-owned, closed corporation. Although many people think that a closed corporation is a small company, there are exceptions. Mars, for example, has annual sales of more than $37 billion, employs more than 130,000 associates worldwide, and operates in 80 different countries.[5]

An **open corporation** (sometimes referred to as a public corporation) is one whose stock can be bought and sold by any individual. Examples of open corporations include General Electric, Microsoft, Apple, and Nike.

stock the shares of ownership of a corporation

stockholder a person who owns a corporation's stock

closed corporation (sometimes referred to as a private corporation) a corporation whose stock is owned by relatively few people and is not sold to the general public

open corporation (sometimes referred to as a public corporation) a corporation whose stock can be bought and sold by any individual

4-4b **Forming a Corporation**

Although you may think that incorporating a business guarantees success, it does not. There is no special magic about placing the word *Incorporated* or the abbreviation *Inc.* after the name of a business. Unfortunately, like sole proprietorships or partnerships, corporations can go broke. The decision to incorporate a business, therefore, should be made only after carefully considering whether the corporate form of ownership suits your needs better than the sole proprietorship or partnership forms. To help you to decide if the corporate form of organization is the right choice, you may want to visit the library. You can also use an internet search engine and enter the term "business incorporation" for useful websites.

Ronald McDonald stops in Bangkok, Thailand, to talk with a customer. When McDonald's opened the first store in 1954, no one—even Ray Kroc, one of the founders of McDonald's—would have dreamed that today the restaurant chain would have more than 38,000 locations in more than 100 different countries around the globe. Part of the reason why the founders chose to incorporate the business was the ability to raise capital that could be used for expansion.

HAND ROBOT/SHUTTERSTOCK.COM

If you decide the corporate form is the best form of ownership for you and your business, most experts recommend obtaining legal advice from an attorney who has helped other clients form a corporation to make sure all legal requirements are met. While it may be possible to incorporate a business without legal help, it is well to keep in mind the old saying, "A man who acts as his own attorney has a fool for a client." Table 4-1 lists some aspects of starting and running a business that may require legal help.

Where to Incorporate A business is allowed to incorporate in any state that it chooses. Most small- and medium-sized businesses are incorporated in the state where they do the most business. The founders of larger corporations or of those that will do business nationwide often compare the benefits that various states provide to corporations. The decision on where to incorporate usually is based on two factors: (1) the cost of incorporating in one state compared with the cost in another state and (2) the advantages and disadvantages of each state's corporate laws and tax structure. Some states are more hospitable than others, and some offer fewer restrictions, lower taxes, and other benefits to attract new firms. Delaware, Nevada, and Wyoming are often chosen by corporations that do business in more than one state because of their corporation-friendly laws and pro-business climate.[6]

An incorporated business is called a **domestic corporation** in the state in which it is incorporated. In all other states where it does business, it is called a **foreign corporation**. Home Depot is incorporated in Delaware, where it is a domestic corporation. In the remaining 49 states, Home Depot is a foreign corporation. Home Depot must register in all states where it does business and may be required to pay taxes and annual fees to each state. A corporation chartered by a foreign government and conducting business in the United States is an **alien corporation**. Royal Dutch Shell, Toyota, Nestlé, and Samsung Corporation are examples of alien corporations.

The Corporate Charter Once a home state has been chosen, the incorporator(s) submits *articles of incorporation* to the secretary of state or appropriate state authority. When the articles of incorporation are approved, they become a contract, often called the corporate charter, between a corporation and the state in which the state recognizes the formation of the artificial person that is the corporation. Usually, the articles of incorporation include the following information:

- The firm's name and address;
- The incorporators' names and addresses;
- The purpose of the corporation;

Table 4-1 Ten Aspects of Business That May Require Legal Help

1. Choosing either the sole proprietorship, partnership, corporate, or some special form of business ownership
2. Constructing a partnership agreement
3. Incorporating a business
4. Registering a corporation's stock
5. Obtaining a trademark, patent, or copyright
6. Filing for licenses or permits at the local, state, and federal levels
7. Purchasing an existing business or real estate
8. Creating valid contracts
9. Hiring employees and independent contractors
10. Extending credit and collecting debts

domestic corporation a corporation in the state in which it is incorporated

foreign corporation a corporation in any state in which it does business except the one in which it is incorporated

alien corporation a corporation chartered by a foreign government and conducting business in the United States

- The maximum amount of stock and types of stock to be issued;
- The length of time the corporation is to exist; and
- The name and address of the corporation's registered agent.

Before making a decision to organize your business as a corporation, you may want to consider two additional areas: stockholders' rights and the importance of the organizational meeting.

Stockholders' Rights Even if you own a single share of stock, you're legally a part owner of the corporation. There are two basic types of stock. Owners of **common stock** may vote on corporate matters. Generally, an owner of common stock has one vote for each share owned. However, any claims of common stockholders on profits, dividends, and assets of the corporation are paid after the claims of others. The owners of **preferred stock** usually have no voting rights, but their claims on dividends are paid before those of common stockholders. Although some large corporations may issue both common and preferred stock, smaller corporations generally issue only common stock.

Perhaps the most important right of owners of both common and preferred stock is to share in the profit earned by the corporation through the payment of dividends. A **dividend** is a distribution of earnings to the stockholders of a corporation. Other rights include receiving information about the corporation, voting on changes to the corporate charter, and attending the corporation's annual stockholders' meeting, where they may exercise their right to vote.

Because common stockholders usually live all over the nation, very few may actually attend a corporation's annual meeting. Instead, they vote by proxy. A **proxy** is a legal form listing issues to be decided at a stockholders' meeting and enabling stockholders to transfer their voting rights to some other individual or individuals. A stockholder can register a vote and transfer voting rights simply by signing and returning the proxy form. Today, most corporations also allow stockholders to exercise their right to vote by proxy by accessing the internet or using a toll-free phone number.

Organizational Meeting As the last step in forming a corporation, the incorporators and original stockholders meet to adopt corporate bylaws and elect their first board of directors. (Later, directors will be elected or reelected at the corporation's annual meetings by the firm's stockholders.) The board members are directly responsible to the stockholders for the way they operate the firm.

4-4c Corporate Structure

The organizational structure of most corporations is more complicated than that of a sole proprietorship or partnership. In a corporation, both the board of directors and the corporate officers are involved in management.

Board of Directors As an artificial person, a corporation can act only through its directors, who represent the corporation's stockholders. The **board of directors** is the top governing body of a corporation and is elected by the stockholders. In theory, then, the stockholders are able to control the activities of the entire corporation through its directors because they are the group that elects the board of directors (refer to Figure 4-4).

common stock the most basic form of corporate ownership and whose owners may vote on corporate policies

preferred stock stock owned by individuals or firms who usually do not have voting rights but whose claims on dividends are paid before those of common-stock owners

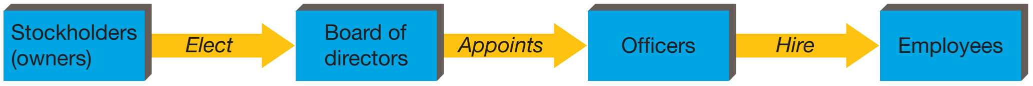
dividend a distribution of earnings to the stockholders of a corporation

proxy a legal form listing issues to be decided at a stockholders' meeting and enabling stockholders to transfer their voting rights to some other individual or individuals

board of directors the top governing body of a corporation, the members of which are elected by the stockholders

Figure 4-4 Hierarchy of Corporate Structure

Stockholders exercise a great deal of influence through their right to elect the board of directors.



Board members can be chosen from within the corporation or from outside it. *Note:* For a small corporation, only one director is required in many states, although you can choose to have more. In larger corporations, directors who are elected from within the corporation are usually its top managers—the president and executive vice presidents, for example. Those elected from outside the corporation generally are experienced managers or entrepreneurs with proven leadership ability and/or specific talents the organization seems to need. In smaller corporations, majority stockholders usually serve as board members.

The major responsibilities of the board of directors are to set company goals and develop general plans (or strategies) for meeting those goals. The board is also responsible for the firm's overall operation and appointing corporate officers.

Corporate Officers **Corporate officers** are appointed by the board of directors. Although a small corporation may not have all of the following officers, the chairperson of the board, president, executive vice presidents, corporate secretary, and treasurer are all corporate officers. They help the board make plans, carry out strategies established by the board, hire employees, and manage day-to-day business activities. Periodically (usually each month), they report to the board of directors. And at the annual meeting, the directors report to the stockholders.

✓ Concept Check

- Explain the difference between an open corporation and a closed corporation.
- How is a domestic corporation different from a foreign corporation and an alien corporation?
- Outline the incorporation process, and describe the basic corporate structure.
- What rights do stockholders have?

4-5 Advantages and Disadvantages of Corporations

Learning Objective

4-5 Describe the advantages and disadvantages of a corporation.

When Warren Buffett started his first partnership more than 60 years ago, he never dreamed he would wind up putting together a wildly diverse collection of businesses under one corporate umbrella. It all started when Buffett set up a series of partnerships with family and friends to pool cash for buying big blocks of stock in companies he had researched. Not all of the companies Buffett chose paid off, but many were so successful that Buffett quickly earned a worldwide reputation for his ability to pick just the "right" company. Today, Berkshire Hathaway now owns more than 60 different companies, brings in more than $250 billion in annual revenue, and employs 390,000 people.

Although Warren Buffett started with partnerships, he eventually chose the corporate form of ownership because it provided a number of advantages when compared to a partnership or the other forms of business ownership.

4-5a Advantages of Corporations

Limited Liability **Limited liability** is a feature of corporate ownership that limits each owner's financial liability to the amount of money that they have paid for the corporation's stock. This feature arises from the fact that the corporation is itself a legal person, separate from its owners. If a corporation fails or is involved in a lawsuit and loses, creditors have a claim only on the corporation's assets. Because it overcomes the problem of unlimited liability connected with sole proprietorships and general partnerships, limited liability is one of the chief reasons why entrepreneurs often choose the corporate form of organization. For example, Ford Motor Company and Tesla are both incorporated because of the limited liability protection provided by the corporate form of ownership. The limited liability protection is often referred to as the "corporate veil," and protects the personal assets of investors, executives, and employees in case a corporation is sued.

Ease of Raising Capital The corporation is one of the most effective forms of business ownership for raising capital. Like sole proprietorships and partnerships, corporations can borrow from lending institutions. However, they also can raise additional sums of money by selling stock. In fact, the amount of capital that can

corporate officers the chairperson of the board, president, executive vice presidents, corporate secretary, treasurer, and any other top executive appointed by the board of directors

limited liability a feature of corporate ownership that limits each owner's financial liability to the amount of money that they have paid for the corporation's stock be raised by selling stock can be staggering. Snowflake, a company that provides a cloud-based data platform that enables customers to consolidate and share data to improve decision making, raised more than $3 billion by selling stock in late 2020.[7] Money from an initial public offering (IPO) can be used by a corporation for expansion, to repay debt, or for any valid reason. While not all IPOs are as large as Snowflake's, individuals are more willing to invest in corporations than in other forms of business because of limited liability, and they can generally sell their stock easily—hopefully for a profit.

Ease of Transfer of Ownership Accessing a brokerage firm website or a telephone call to a stockbroker is all that is required to sell stock in a public corporation. Willing buyers are available for most stocks at the current market price. Ownership is transferred when the sale is made, and practically no restrictions apply to the sale and purchase of stock issued by a public corporation.

Perpetual Life Since it is essentially a legal "person," a corporation exists independently of its owners and survives them. The withdrawal, death, or incompetence of a key executive or owner does not cause the corporation to be terminated. Kellogg's was originally founded in 1906 and is one of the world's largest cereal manufacturers, even though its original founder, W. K. Kellogg, has been dead for decades.

Specialized Management Typically, corporations are able to recruit more skilled, knowledgeable, and talented managers than proprietorships and partnerships. Both Google and Apple can attract employees with the best talent and skills in the industry because people want to work for successful companies that have a history of developing new ideas or services. Corporations—especially those in high-demand industries—also pay larger salaries, offer excellent employee benefits, and are large enough to offer considerable opportunity for employee advancement. Within the corporate structure, administration, human resources, finance, marketing, distribution, and manufacturing are placed in the charge of experts in these fields.

Airbnb sold stock to investors and raised $3.5 billion. On Wall Street, the term initial public offering (IPO) is used to describe a company's first public stock offering. Airbnb—a company that uses an online platform or mobile device to match property owners with guests for vacation rentals—was one of the largest IPOs in recent history. Investors who bought shares in the Airbnb IPO believed the company would increase revenues and profits *and* its stock would increase in value.

ALESIAKAN/SHUTTERSTOCK.COM

Sustaining the Planet

Sustainable-Minded Businesses Eye B Corp Certification

Companies that balance profit with purpose look to B Corp certification to demonstrate their commitment to social responsibility and sustainability. Certified B Corporations voluntarily meet high standards for social and environmental performance, public transparency, and legal accountability. The first 82 B Corps were certified in 2007. Now, there are more than 3,500 across 70 countries.

B Corps use profit for social and environmental good, such as reducing inequality, building strong communities, and creating high-quality jobs. They must meet a minimum B Impact Assessment score that measures each company's impact on employees, customers, community, and the environment. To maintain public transparency, companies must make their scores and information about their full assessment available to the public.

Initially, the group of Certified B Corporations was largely made up of small businesses but now includes major corporations such as food product company Danone North America. Other well-known B Corps include Patagonia Works and New Belgium Brewing. Meeting the rigorous standards of certification can be costly. In the United States, B Corps are required to reincorporate into a benefit corporation or amend their articles of incorporation to legally solidify their commitment. With more and more companies dedicating time and resources to meet B Corp standards, it's clear that many business leaders no longer believe that companies exist only to maximize stockholder profit.

Sources: Based on information in Sarah Shearman, "Purpose over Profit: Are B-Corps the Future of Sustainable Business?" *Reuters*, www.reuters.com/article/idUSKCN20K2H1; Certified B Corporation, "About B Corps," www.bcorporation.net/about-b-corps; Benefit Corporation, "Why Is Benefit Corp Right for Me?" https://benefitcorp.net/businesses/why-become-benefit-corp.

4-5b **Disadvantages of Corporations**

Like its advantages, many of a corporation's disadvantages stem from its legal definition as an artificial person or legal entity. The most serious disadvantages are described in the following text. Also refer to Table 4-2 for a comparison of some of the advantages and disadvantages of a sole proprietorship, general partnership, and corporation.

Difficulty and Expense of Formation The costs of incorporating, in terms of both time and money, often discourage many business owners from forming corporations. For even a small business, the use of an attorney is usually necessary to complete the legal forms that are submitted to the secretary of state. Application fees, attorney's fees, registration costs associated with selling stock, and other

Table 4-2 **Some Advantages and Disadvantages of a Sole Proprietorship, Partnership, and Corporation**

	Sole Proprietorship	General Partnership	Regular C Corporation
Protecting against liability for debts	Difficult	Difficult	Easy
Raising money	Difficult	Difficult	Easy
Ownership transfer	Difficult	Difficult	Easy
Preserving continuity	Difficult	Difficult	Easy
Government regulations	Few	Few	Many
Formation	Easy	Easy	Difficult
Income taxation	Once	Once	Twice

organizational costs can amount to thousands of dollars. Before deciding to incorporate a small business, you may want to review the material in the section "Forming a Corporation" earlier in this chapter.

Government Regulation and Increased Paperwork A corporation must register and meet various government standards before it can sell its stock to the public. Then it must file many reports on its business operations and finances with local, state, and federal governments. In addition, the corporation must make periodic reports to its stockholders. To prepare all the necessary reports, even small corporations often need the help of an attorney, certified public accountant, and other professionals on a regular basis. In addition, a corporation's activities are often restricted by law to those spelled out in its corporate charter.

JAGUAR PS/SHUTTERSTOCK.COM

Oprah gets the red-carpet treatment! While most people recognize Oprah Winfrey as a talk-show host, she is also an accomplished actor, author, television executive, *and* businessperson. She has starred in movies, produced Broadway shows, written best-selling books, founded *O Magazine* and Harpo Productions, and is recognized as a philanthropist who supports many diverse charitable causes. Today, many people believe she has used her talents and business skills to become one of the most influential people in the twenty-first century.

Conflict Within the Corporation Because a large corporation may employ thousands of employees, some conflict is inevitable. For example, the pressure to increase sales revenue, reduce expenses, and increase profits often leads to increased stress and tension for both managers and employees in all types of business ownership. This is especially true when a corporation operates in a competitive industry, attempts to develop and market new products, or must downsize the workforce to reduce employee salary expense. Consider what happened in early 2020 when non-essential businesses were closed because of the COVID-19 pandemic. Managers had to make hard decisions that affected employees. Do we lay off workers and, if so, which ones? They also had to make decisions about how to pay expenses when there were no sales during the closures. Even when businesses began to reopen, they had to make decisions about which stores to reopen, which ones to permanently close, and how to keep employees and customers safe. Decisions of this type are always hard and create stress and conflict for everyone involved.

Double Taxation Corporations must pay a tax on their profits. In addition, stockholders must pay a personal income tax on profits received as dividends. Corporate profits thus are taxed twice—once as corporate income and a second time as the personal income of stockholders. *Note:* Both the S corporation and the limited liability company (LLC) discussed in the next section eliminate the disadvantage of double taxation and are a primary reason why business owners choose these special types of business ownership.

✓ Concept Check

- What are the advantages of a corporation?
- What are the disadvantages of a corporation?

Lack of Secrecy Because open corporations are required to submit detailed reports to government agencies and to stockholders, they cannot keep all of their operations confidential. Competitors can study these corporate reports and then use the information to compete more effectively. In effect, every public corporation has to share some of its secrets about its management, finances, and other business activities with its competitors.

Learning Objective

4-6 Examine special types of businesses, including S corporations, limited liability companies, and not-for-profit corporations.

4-6 Special Types of Business Ownership

In addition to the sole proprietorship, partnership, and the regular corporate forms of organization, some entrepreneurs choose other forms of organization that meet their special needs. Additional organizational options include S corporations, LLCs, and not-for-profit corporations.

4-6a **S Corporations**

If a corporation meets certain requirements, its directors may apply to the Internal Revenue Service (IRS) for status as an S corporation. An **S corporation** is a corporation that is taxed as though it were a partnership. In other words, the corporation's income is taxed only as the personal income of its stockholders. Corporate profits or losses "pass through" the business and are reported on the owners' personal income tax returns.

To qualify for the special status of an S corporation, the first step is to file the necessary paperwork to become a corporation. A number of issues described in the section "Forming a Corporation" must be decided and paperwork must be filed with the secretary of state or appropriate state authority. Once the corporation is established, the shareholders of the corporation must elect to become an S corporation and submit Form 2553 to the IRS. In addition to completing the form, a firm must meet the following criteria[8]:

1. No more than 100 stockholders are allowed.
2. Stockholders must be individuals, estates, or certain trusts.
3. The corporation has no nonresident, alien shareholders.
4. There can be only one class of outstanding stock.
5. The firm must be a domestic corporation eligible to file for S corporation status.
6. All stockholders must agree to the decision to form an S corporation.

Becoming an S corporation can be an effective way to avoid double taxation while retaining the corporation's legal benefit of limited liability.

4-6b **Limited Liability Companies**

A **limited liability company (LLC)** is a form of business ownership that combines the benefits of a corporation and a partnership while avoiding some of the restrictions and disadvantages of those forms of ownership. Chief advantages of an LLC are as follows:

1. Like a sole proprietorship or partnership, an LLC enjoys pass-through taxation. This means that owners—who are called members in an LLC—report their share of profits or losses in the company on their individual tax returns and avoid the double taxation imposed on most corporations. LLCs with at least

S corporation a corporation that is taxed as though it were a partnership

limited liability company (LLC) a form of business ownership that combines the benefits of a corporation and a partnership while avoiding some of the restrictions and disadvantages of those forms of ownership

LINDA PARTON/SHUTTERSTOCK.COM

General Motors: A limited liability company. A limited liability company doesn't have to be small. General Motors—the parent company of Cadillac, Chevrolet, Buick, and GMC—produces and sells automobiles in many countries around the globe. General Motors chose the limited liability company form of ownership to avoid some of the restrictions and disadvantages of other forms of ownership.

two members are taxed like a partnership. LLCs with just one member are taxed like a sole proprietorship. LLCs can even elect to be taxed as a corporation or S corporation if there are benefits to offset the corporate double taxation and other restrictions.

2. Like a corporation, it provides limited liability protection for acts and debts of the LLC. An LLC thus extends the concept of personal asset protection to small business owners.
3. The LLC type of organization provides more management flexibility and fewer restrictions when compared with corporations. A corporation, for example, is required to hold annual meetings and record meeting minutes; an LLC is not.

Although many experts believe that the LLC is nothing more than a variation of the S corporation, there is a difference. An LLC is not restricted to 100 stockholders—a common drawback of the S corporation. Although the laws for forming an LLC are slightly different in each state, the owners of an LLC may file the required articles of organization in any state. Most choose to file in their home state—the state where they live and do most of their business.

Even though most LLCs are small- to medium-sized businesses, an LLC doesn't have to be small. Both General Motors and BMW of North America chose the LLC type of business ownership because it provided limited liability for investors and avoided some of the restrictions and disadvantages of other forms of business ownership.

For help in understanding the differences between a regular corporation, an S corporation, and an LLC, refer to Table 4-3.

American Red Cross
Together, we can save a life

360B/SHUTTERSTOCK.COM

4-6c Not-for-Profit Corporations

A **not-for-profit corporation** (sometimes referred to as a *nonprofit*) is a corporation organized to provide a social, educational, religious, or other service rather than to earn a profit. Various museums, private schools, colleges, and charitable organizations are organized in this way, primarily to ensure limited liability.

While the process used to organize a not-for-profit corporation is similar to the process used to create a regular corporation, each state does have different laws. Once approved by state authorities, not-for-profit corporations must meet specific Internal Revenue Service guidelines in order to obtain tax-exempt status.

Today, there is a renewed interest in not-for-profits because these organizations are often formed to improve

Table 4-3 Some Advantages and Disadvantages of a Regular Corporation, an S Corporation, and a Limited Liability Company

	Regular C Corporation	S Corporation	Limited Liability Company
Double taxation	Yes	No	No
Limited liability and personal asset protection	Yes	Yes	Yes
Management flexibility	No	No	Yes
Restrictions on the number of owners/stockholders	No	Yes	No
Internal Revenue Service tax regulations	Many	Many	Fewer

not-for-profit corporation (sometimes referred to as *nonprofit*) a corporation organized to provide a social, educational, religious, or other service rather than to earn a profit

Entrepreneurial Success

How to Form an LLC for Your Small Business

It's often said that a limited liability company (LLC) combines the best parts of a corporation and a partnership. An LLC offers owners tax benefits, liability protection, and management flexibility. To form an LLC in most states, members file articles of organization, a short form that includes the name and address of the LLC, its organizers, and an effective start date. Though having an attorney is not required, it may be useful to have an attorney to advise on building the articles of organization in order to meet state requirements. While some states call this document by a different name and require slightly different information, they all serve the same purpose. Filing this form costs anywhere from $50 to $300, depending on the state.

LLCs should be considered by sole proprietors, partners, or investors starting a business that want to limit personal liability. Although this type of business ownership can be used to run almost any kind of business, most experts recommend creating an operating agreement, which is similar to a partnership agreement or the bylaws of a corporation, to outline business details such as ownership percentages, management roles, and member rights and responsibilities. Establishing an operating agreement is voluntary, but it can protect the business should legal disputes arise. Although many states do not require annual paperwork or annual registration, documenting major business proceedings and business decisions can serve to protect the LLC and the members of the LLC.

LLCs may cost more to establish than a partnership due to filing fees, but LLCs offer many advantages. One of the most attractive advantages of an LLC is personal asset protection. If the business incurs any debts, for example, the owners are not personally liable. This means if someone sues the company, the owner's personal assets, such as a bank account or home, are protected.

Sources: Based on information in "How to Form an LLC," *The Wall Street Journal*, http://guides.wsj.com/small-business/starting-a-business/how-to-start-an-llc/; Nolo, "What Is a Limited Liability Company (LLC)?" https://www.nolo.com/legal-encyclopedia/what-is-a-limited-liability-company.html; Jean Murray, "How to File Articles of Organization for an LLC," *The Balance Small Business, December* 26, 2019, https://www.thebalancesmb.com/how-to-file-articles-of-organization-for-an-llc-397776.

---

communities and change lives. For example, Habitat for Humanity is a not-for-profit corporation and was formed to provide homes for people who cannot afford housing. Even though this corporation may receive more money than it spends, any surplus funds are "reinvested" in building activities to provide low-cost housing to qualified individuals.

Many not-for-profit corporations operate in much the same way as for-profit businesses. Employees of not-for-profit businesses are responsible for making sure the organization achieves its goals and objectives, ensuring accountability for finances and donations, and monitoring activities to improve the performance of both paid employees and volunteers. If you are interested in a business career, don't rule out the nonprofit sector. You might consider volunteering in a local not-for-profit organization to see if you enjoy this type of challenge.

✓ Concept Check

- Explain the difference between an S corporation and a limited liability company.
- How does a regular C corporation differ from a not-for-profit corporation?

4-7 Joint Ventures and Syndicates

Today, two additional types of business organizations—joint ventures and syndicates—are used for special purposes. Each of these forms of organization is unique when compared with more traditional forms of business ownership.

Learning Objective

4-7 Discuss the purpose of a joint venture and syndicate.

4-7a Joint Ventures

A **joint venture** is an agreement between two or more groups to form a business entity in order to achieve a specific goal or to operate for a specific period of time.

joint venture an agreement between two or more groups to form a business entity in order to achieve a specific goal or to operate for a specific period of time

Both the scope of the joint venture and the liabilities of the people or businesses involved usually are limited to one project. Once the goal is reached, the period of time elapses, or the project is completed, the joint venture is dissolved.

Corporations, as well as individuals, may enter into joint ventures. For example, Pfizer and BioNTech joined forces to develop a potential COVID-19 vaccine in the first part of 2020. Combining the resources of both pharmaceutical firms accelerated the search for a safe vaccine that could be mass produced in order to curb the increase of cases and deaths caused by the COVID-19 virus.[9] Shared information from each firm's research teams in the United States and Germany helped create a vaccine that was available to people around the world by the end of 2020.[10]

4-7b **Syndicates**

A **syndicate** is a temporary association of individuals or firms organized to perform a specific task that requires a large amount of money. The syndicate is formed because no one person or firm is willing to put up the entire amount required for the undertaking. Like a joint venture, a syndicate is usually dissolved as soon as its purpose has been accomplished.

Syndicates are used most commonly to underwrite large insurance policies, loans, and investments. To share the risk of default, banks have formed syndicates to provide loans to developing countries. Stock brokerage firms usually join together in the same way to market a new issue of stock. In late 2020, Leslie's—one of the largest and most trusted pool supply companies in the United States, sold stock to investors. With the help of a syndicate including Goldman Sachs & Company, Morgan Stanley, Bank of America Securities, and other Wall Street firms, Leslie's raised $680 million through its initial public offering. (An *initial public offering* is the term used to describe the first time a corporation sells stock to the general public.) Once the stock was sold, Leslie's used the money to improve its cash balance and fund growth and expansion.

✓ Concept Check

- In your own words, define a joint venture and a syndicate.
- In what ways are joint ventures and syndicates alike? In what ways do they differ?

4-8 Corporate Growth

Learning Objective

4-8 Explain how growth from within and growth through mergers can enable a business to expand.

Growth seems to be a basic characteristic of business. One reason for seeking growth has to do with profit: A larger firm generally has greater sales revenue and thus greater profit. Another reason is that in a growing economy, a business that does not grow is actually shrinking relative to the economy. A third reason is that business growth is a means by which some executives boost their power, prestige, and reputation.

Growth poses new problems and requires additional resources that first must be available and then must be used effectively. The main ingredient in growth is capital—and as we have noted, capital is most readily available to corporations.

4-8a **Growth from Within**

Most corporations grow by expanding their present operations. Some introduce and sell new but related products. Others expand the sale of present products to new geographic markets or to new consumers in geographic markets already served. Although Walmart was started by Sam Walton in 1962 with one discount store, today Walmart has approximately 10,500 stores in the United States and 23 other countries, serves 220 million customers each week, and has long-range plans to increase its online business activities and expand into additional international markets.[11]

Growth from within, especially when carefully planned and controlled, can have relatively little adverse effect on a firm. For the most part, the firm continues to do what it has been doing, but on a larger scale. For instance, Larry Ellison, co-founder, Chairman of the Board, and Chief Technology Officer of Oracle Corporation of Austin, Texas, built the firm's annual revenues up from a mere $282 million in 1988 to over $39 billion today.[12] Much of this growth has been fueled by two factors.

syndicate a temporary association of individuals or firms organized to perform a specific task that requires a large amount of money

BLOOMBERG/GETTY IMAGES

Sundar Pichai knows his Alphabet really well! Mr. Pichai is the CEO of Alphabet—a company worth more than $1.2 trillion. His leadership and management skills have helped build a company recognized around the globe for its innovation and the way it has changed the way people use the internet. Although the Google search engine is Alphabet's most successful segment, the parent company is always looking for acquisitions that can help it become even larger in the future.

First, Oracle has worked hard to take advantage of its leadership position in the information technology industry to generate more sales and profits. Second, Oracle has used its profits to evaluate and then acquire other companies that can complement its position in the information technology industry.

Technology and Innovation

Intel Gets a Move On with Mobileye and Moovit

To fulfill its purpose to "create world-changing technology that enriches the lives of every person on earth," Intel—a company known for state-of-the-art chips and electronic components—has expanded into technology for autonomous driving vehicles. In 2017, Intel acquired Mobileye for just over $15 billion. Mobileye is based on developing technology in three areas—automated driving, advanced driver systems, and mapping software. Today, Mobileye enables advanced driver assistance systems (ADAS) in more than 60 million vehicles and is used by more than 25 automakers. With the acquisition of Mobileye, Intel plans to make roads safer and reduce traffic congestion with new automotive technology solutions.

Now Intel has doubled down on its automotive technology investments with the acquisition of Moovit for $900 million. Moovit is an Israeli start-up that analyzes traffic patterns and makes public transit recommendations. It currently provides data to Intel, Uber, and 7,500 transit authorities. Intel intends to use Moovit's technology to accelerate Mobileye's entry into the Mobility-as-a-Service (MaaS) market. MaaS is a relatively new service that enables users to arrange and pay for transportation using multiple types of vehicles. Instead of owning a vehicle, users can use a Maas service. MaaS providers include not only automobile ridesharing companies but also bicycle- and scooter-sharing companies. Adding Moovit's global user base, transportation data, strong partnerships, and employees can only speed Intel's and Mobileye's move to capture the MaaS market.

Tech giants such as Intel often acquire small to mid-sized tech start-ups to expand their capabilities and expand their reach into developing markets. The cost of developing their own traffic analysis and advanced driver assistance system technologies from the ground up—not to mention recruiting top talent and mastering new markets—would be substantial. By combining Intel's resources, Mobileye's technology, and Moovit's proprietary software and data, all three companies can gain a strong foothold in emerging automotive markets.

Sources: Based on information in Ingrid Lunden, "Confirmed: Intel Is Buying Urban Mobility Platform Moovit in a $900m Deal," *TechCrunch*, May 4, 2020, www.techcrunch.com/2020/05/04/confirmed-intel-is-buying-urban-mobility-platform-moovit-in-a-900m-deal/; Intel, "Intel Acquires Moovit to Accelerate Mobileye's Mobility-as-a-Service Offering," May 4, 2020, newsroom.intel.com/news-releases/intel-may-2020-acquisition/; Andrew J. Hawkins, "Intel Acquires Transit Data Startup Moovit for $900 Million," *The Verge*, May 4, 2020, www.theverge.com/2020/5/4/21246672/intel-moovit-acquisition-self-driving-mobility-robotaxi.

4-8b **Growth Through Mergers and Acquisitions**

Another way a firm can grow is by purchasing another company. The combining of two corporations or other business entities to form one business is called a **merger**. An *acquisition* is essentially the same thing as a merger, but the term generally is used in reference to a large corporation's purchase of another corporation.

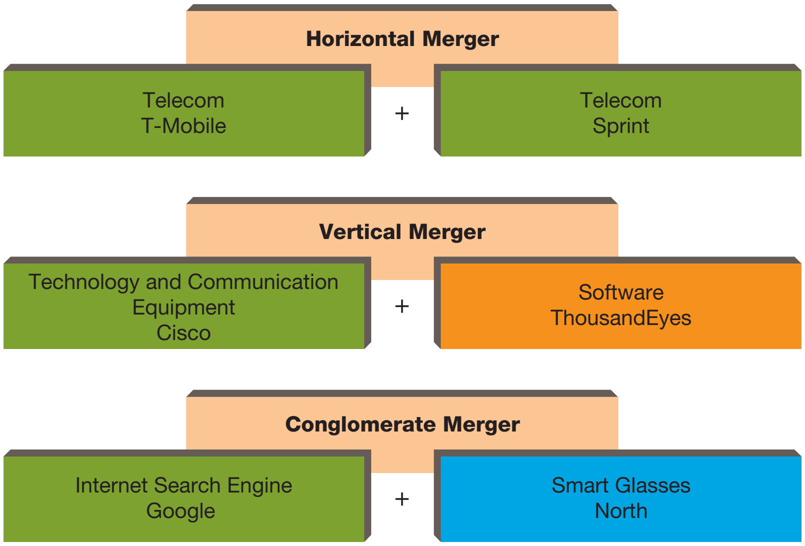
Although most mergers and acquisitions are friendly, hostile takeovers also occur. A **hostile takeover** is a situation in which the management and board of directors of a firm targeted for acquisition disapprove of the merger. Whether mergers are friendly or hostile, they are generally classified as *horizontal, vertical,* or *conglomerate* (refer to Figure 4-5).

Horizontal Mergers A *horizontal merger* is a merger between firms that make and sell similar products or services in similar markets. The merger between T-Mobile and Sprint is an example of a horizontal merger because both firms are in the telecom industry. This type of merger tends to reduce the number of firms in an industry—and thus may reduce competition. In this case, regulators were concerned about the effect a merger would have on the firms' customers. For example, if regulators approved the merger of T-Mobile and Sprint, the price of cell phone service and related technology could increase. Obtaining approval for a merger like this one can be difficult—especially when customers could end up paying more for the same product or service because the market or industry is less competitive after the merger. In this situation, the companies must work with regulators in order to obtain approval. In some cases, mergers are never completed because of opposition from regulators or many other reasons.

Vertical Mergers A *vertical merger* is a merger between firms that operate at different but related levels in the production and marketing of a product. Generally, one of the merging firms is either a supplier or a customer of the other. A vertical merger occurred when Cisco paid approximately $1 billion to acquire ThousandEyes—a smaller company that has developed software to monitor if the end user of an internet service is getting what's intended, trace how that service is delivered, and spot potential problems.[13] Rather than develop its own software, it simply purchased the ThousandEyes company. Other big technology firms including

Figure 4-5 Three Types of Growth by Merger

Today, mergers are classified as horizontal, vertical, or conglomerate.



merger the combining of two corporations or other business entities to form one business

hostile takeover a situation in which the management and board of directors of a firm targeted for acquisition disapprove of the merger

Facebook, Amazon, Apple, Microsoft, and Alphabet are also using vertical mergers to acquire smaller companies with products that use advanced artificial intelligence.[14]

Conglomerate Mergers A *conglomerate* merger takes place between firms in completely different industries. A conglomerate merger occurred when Alphabet's Google Segment bought North—a Canadian company that makes Focals smart glasses for an undisclosed amount. Google, known as the most popular search engine in the world, has a history of investing in new technology products and services. By acquiring North, Google will be able to use North's technological expertise to develop smart glasses that can superimpose computer-generated images over what users see in the real world when they look through the smart glasses.[15] The merger was a friendly merger because it was beneficial to both companies.

4-8c Merger and Acquisition Trends for the Future

While there have always been mergers and acquisitions, the current economy has changed the dynamics of how and why firms merge. Most experts now predict that future mergers and acquisitions will be the result of cash-rich companies looking to acquire businesses that will enhance their position in the marketplace or an industry. Analysts also anticipate more mergers that involve companies or investors from other countries. Regardless of the companies involved or where the companies are from, future mergers and acquisitions will be driven by solid business logic and the desire to compete with other firms in very competitive industries and the international marketplace.

Whether they are sole proprietorships, partnerships, corporations, or some other form of business ownership, most U.S. businesses are small. In the next chapter, we focus on these small businesses. We examine, among other things, the meaning of the word *small* as it applies to business and the importance of small business for the American economy.

✓ Concept Check

- What happens when a firm makes a decision to grow from within?
- What is a hostile takeover? How is it different from a friendly merger or acquisition?
- Explain the three types of mergers.

Summary

4-1 Describe the advantages and disadvantages of sole proprietorships.

In a sole proprietorship, all business profits become the property of the owner, but the owner is also personally responsible for all business debts. A successful sole proprietorship can be a great source of pride for the owner. When comparing different types of business ownership, the sole proprietorship is the simplest form of business to enter, control, and leave. It also pays no special taxes. Perhaps for these reasons, 72 percent of all American business firms are sole proprietorships. Sole proprietorships nevertheless have disadvantages, such as unlimited liability and limits on one person's ability to borrow or to be an expert in all fields. As a result, this form of ownership accounts for only 4 percent of total revenues when compared with partnerships and corporations.

4-2 Explain the different types of partners and the importance of partnership agreements.

Like sole proprietors, general partners are responsible for running the business and for all business debts. Limited partners receive a share of the profit in return for investing in the business. However, they are not responsible for business debts beyond the amount they have invested. Regardless of the type of partnership, it is always a good idea to have a written agreement (or articles of partnership) setting forth the terms of a partnership.

4-3 Describe the advantages and disadvantages of partnerships.

Although partnership eliminates some of the disadvantages of sole proprietorship, it is the least popular of the major forms of business ownership. The major advantages of a partnership include ease of start-up, availability of capital and credit, personal interest, combined skills and knowledge, retention of profits, and possible tax advantages. The effects of management disagreements are one of the major disadvantages of a partnership. Other disadvantages include unlimited liability (in a general partnership), lack of continuity, and frozen investment. By forming a limited partnership, the disadvantage of unlimited liability may be eliminated for the limited partner(s). Partners in a limited liability partnership (LLP) may also have limited liability for the malpractice and negligence of the other partners. Of course, special requirements must be met if partners form either the limited partnership or the LLP.

4-4 Summarize how a corporation is formed.

A corporation is an artificial person created by law, with most of the legal rights of a real person, including the right to start and operate a business, to buy or sell property, to borrow money, to be sued or sue, and to enter into contracts. With the corporate form of ownership, stock can be sold to individuals or other companies to raise capital. The people who own a corporation's common or preferred stock are called stockholders. Stockholders are entitled to receive any dividends paid by the corporation, and common stockholders can vote either in person or by proxy.

Most experts believe that the services of a lawyer are necessary when making decisions about where to incorporate and about obtaining a corporate charter, issuing stock, holding an organizational meeting, and all other legal details involved in incorporation. In theory, stockholders are able to control the activities of the corporation because they elect the board of directors who appoint the corporate officers.

4-5 Describe the advantages and disadvantages of a corporation.

Perhaps the major advantage of the corporate form of ownership is limited liability—stockholders are not liable for the corporation's debts beyond the amount they paid for its stock. Other important advantages include ease of raising capital, ease of transfer of ownership, perpetual life, and specialized management. A major disadvantage of a large corporation is double taxation: All profits are taxed once as corporate income and again as personal income because stockholders must pay a personal income tax on their dividend income. Other disadvantages include difficulty and expense of formation, government regulation, conflict within the corporation, and lack of secrecy.

4-6 Examine special types of businesses, including S corporations, limited liability companies, and not-for-profit corporations.

S corporations are corporations that are taxed as though they were partnerships but that enjoy the benefit of limited liability. To qualify as an S corporation, a number of criteria must be met. An LLC is a form of business ownership that provides limited liability and has fewer restrictions when compared to a regular corporation or an S corporation. LLCs also avoid the double taxation imposed on most corporations. When compared with a regular corporation or an S corporation, an LLC is more flexible. Not-for-profit corporations are formed to provide social services and to improve communities and change lives rather than to earn profits.

4-7 Discuss the purpose of a joint venture and syndicate.

Two additional forms of business ownership—the joint venture and a syndicate—are used by their owners to meet special needs. A joint venture is formed when two or more groups form a business entity in order to achieve a specific goal or to operate for a specific period of time. Once the goal is reached, the period of time elapses, or the project is completed, the joint venture is dissolved. A syndicate is a temporary association of individuals or firms organized to perform a specific task that requires large amounts of capital. Like a joint venture, a syndicate is dissolved as soon as its purpose has been accomplished.

4-8 Explain how growth from within and growth through mergers can enable a business to expand.

A corporation may grow by expanding its present operations or through a merger or an acquisition. Although most mergers are friendly, hostile takeovers also occur. A hostile takeover is a situation in which the management and board of directors of a firm targeted for acquisition disapprove of the acquisition. Mergers generally are classified as horizontal, vertical, or conglomerate.

While there have always been mergers and acquisitions, the current economy has changed the dynamics of how and why firms merge. First, experts predict that future mergers will be the result of cash-rich companies looking to acquire businesses that will enhance their position in the marketplace or an industry. Second, more mergers are likely to involve foreign companies or investors. Third, mergers will be driven by solid business logic and the desire to compete with other firms in very competitive industries and the international marketplace.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

sole proprietorship (103)
unlimited liability (105)
partnership (107)
general partner (107)
limited partner (107)
corporation (111)
stock (112)
stockholder (112)

closed corporation (112)
open corporation (112)
domestic corporation (113)
foreign corporation (113)
alien corporation (113)
common stock (114)
preferred stock (114)
dividend (114)
proxy (114)
board of directors (114)
corporate officers (115)
limited liability (115)
S corporation (119)
limited liability company (LLC) (119)
not-for-profit corporation (120)
joint venture (121)
syndicate (122)
merger (124)
hostile takeover (124)

Discussion Questions

1. If you were to start a business, which ownership form would you choose? What factors might affect your choice?
2. Why might an investor choose to become a partner in a limited partnership instead of purchasing the stock of an open corporation?
3. Discuss the following statement: "Corporations are not really run by their owners."
4. What kinds of services do not-for-profit corporations provide? Would a career in a not-for-profit corporation appeal to you?
5. Is growth a good thing for all firms? How does management know when a firm is ready to grow?
6. As an entrepreneur, you'll face lots of tough and sometimes ethical decisions. In the situation described below, what do you think is the right thing to do? A potential customer wants to visit your place of business. Should you introduce friends as "employees" and "customers" so your firm looks bigger and busier?

Case 4

It's a Family Affair at SC Johnson

SC Johnson, a multi-billion-dollar family-owned business, is a multinational manufacturer of household and professional products. Windex, Pledge, Drano, Scrubbing Bubbles, and Shout are just a few brands included in SC Johnson's product portfolio. Today, Fisk Johnson is a fifth-generation family member and CEO for the privately-held company, which was founded in 1886.

It all started because of an entrepreneur named Samuel Curtis Johnson, a parquet floor salesman in Racine, Wisconsin. He traveled around Wisconsin and surrounding states selling flooring to contractors and returned home on weekends to perform managerial duties. He noted that his customers would often ask how to care for their new flooring, and, recognizing that a high-quality floor cleaning product was missing from the market, he set out to create the perfect product to meet his customers' needs. The end result was Johnson's Prepared Wax. Initially, he gave a can of wax to customers with their flooring orders, but demand grew beyond the customers that purchased his parquet flooring. By 1898, sales of Johnson's floor-care products exceeded flooring sales.

Now, SC Johnson is one of the oldest family-owned businesses in the United States. In the company's more than 130-year history, its owners have never taken the company public unlike competitors Unilever and Procter & Gamble.

Being privately held offers many advantages. For instance, privately held companies are not required to reveal financial results to the public. According to Fisk Johnson, the financial reports that public companies must file with the government and Wall Street are a great source of information on competitors. Being privately owned also allows the company to remain true to its values rather than answer to shareholders and investors.

Another key to SC Johnson's success is investing in research and development (R&D). The SC Johnson Research Tower, its former hub for R&D, operated from 1950 to 1982 and gave birth to brands such as Raid, Glade, Off!, and Pledge. As the company's product line continued to grow, the company's R&D efforts outgrew the Research Tower facility, and the department moved to a larger facility. Today, one of the key factors for the company's R&D efforts is how each ingredient in a product will impact people and the environment. SC Johnson's Greenlist program, for example, assures customers the company has evaluated the ingredients that go into its products. The goal—to protect human health and the environment—looks at hazard and risk in a four-step evaluation process that reviews the following criteria: (1) chronic human health hazards, (2) long-term environmental hazards, (3) acute risks to human and environmental health, and (4) other potential effects. If an ingredient is flagged as potentially hazardous, SC Johnson will then determine what concentration of the ingredient is appropriate for use before the final product is approved to begin the manufacturing process. In some cases, ingredients or even products are rejected. For example, the company has banned 200 unique raw materials and more than 2,400 fragrance materials.

According to CEO Johnson, remaining private allows the company to prioritize people over profit. Because SC Johnson believes employees should be treated with integrity, respect, and fairness, the company has earned a reputation for being a great place to work. The company has also received recognition for diversity and inclusion, scoring a perfect 100 percent on the 2020 Corporate Equality Index from the Human Rights Campaign. Beyond its own employees, SC Johnson is committed to strengthening communities around the world. For example, through the company's 20 Days of Giving campaign, it donated $400,000 to organizations in communities where it operates to support economic and social mobility in underserved areas. And during the COVID-19 pandemic, SC Johnson donated $10 million to support public needs and individuals on the front lines.

SC Johnson is also finding new ways to support the environment by reducing plastic packaging to eliminate waste. In 2020, SC Johnson joined the Coalition of Action on Plastic Waste alongside Coca-Cola, Walmart, Pepsi, and others. The goal of the coalition is to develop a circular approach to plastic use in the consumer goods industry. SC Johnson aims to make 100 percent of its plastic packaging recyclable, reusable, or compostable.

Samuel Curtis Johnson's floor wax laid the foundation for a thriving private company and family business. Stockholders and industry analysts often exert pressure on public companies to improve financial performance, but SC Johnson has the freedom to make the best decisions for customers, employees, and the environment, even if it comes at the expense of short-term profits. In this way, SC Johnson looks to the future while honoring its past.[16]

Discussion Questions

1. SC Johnson has a long history of developing consumer and household products. How has research and development enabled the company to develop new products that are consumer safe and environmentally friendly?
2. SC Johnson competes with Unilever, Procter & Gamble, and other large corporations that have stockholders and yet, SC Johnson has chosen to remain a private, family business. What are the advantages of management's decision to remain private? Are there disadvantages of this type of private ownership?
3. Back in 1886, Samuel Curtis Johnson started a small business; today that business is a large, successful *private* corporation. How does being private impact customers, employees, and the environment?

Building Skills for Career Success

1. Social Media Exercise

Not-for-profit organizations have used social media to redefine how they can get funding for their missions. There are some not-for-profits that exist totally online. Check out www.donorschoose.org and www.kiva.org. Both of these depend on crowds (called crowdfunding) to either fund educational projects (Donors Choose) or lend money to support projects all over the world (Kiva) using the microfinancing model.

Assignment

1. Take a minute to explore both sites and view some of the projects up for funding. Do you think social media is an effective method of raising money for worthwhile projects? Why or why not?
2. Both Donors Choose and Kiva are not-for-profits; do you think crowdfunding could be useful for "for-profit" businesses? Why or why not?
3. Write a report that describes what you have learned from this exercise.

2. Building Team Skills

Suppose that you have decided to quit your job as an insurance adjuster and open a bakery. Your business is now growing, and you have decided to add a full line of catering services. This means more work and responsibility. You will need someone to help you, but you are undecided about what to do. Should you hire an employee or find a partner? If you add a partner, what type of decisions should be made to create a partnership agreement?

Assignment

1. In a group, discuss the following questions:
    a. What are the advantages and disadvantages of adding a partner versus hiring an employee?
    b. Assume that you have decided to form a partnership. What information and articles should be included in a partnership agreement?
    c. How would you go about finding a partner?
2. As a group, prepare an articles-of-partnership agreement. Be prepared to discuss the pros and cons of your group's partnership agreement with other groups from your class, as well as to examine their agreements.
3. Summarize your group's answers to these questions, and present them to your class.

3. Researching Different Careers

Many people spend their entire lives working in jobs that they do not enjoy. Why? Often, it is because they have taken the first job they were offered without giving it much thought. How can you avoid having this happen to you? First, you should determine your "personal profile" by identifying and analyzing your own strengths, weaknesses, things you enjoy, and things you dislike. Second, you should identify the types of jobs that fit your profile. Third, you should identify and research the companies that offer those jobs.

Assignment

1. Take two sheets of paper and draw a line down the middle of each sheet, forming two columns on each page. Label column 1 "Things I Enjoy or Like to Do," column 2 "Things I Do Not Like Doing," column 3 "My Strengths," and column 4 "My Weaknesses."
2. Record data in each column over a period of at least one week. You may find it helpful to have a relative or friend give you input.
3. Summarize the data, and write a profile of yourself.
4. Take your profile to a career counselor at your college or to the public library and ask for help in identifying jobs that fit your profile. Your college may also offer testing to assess your skills and personality. The internet is another resource.
5. Research the companies that offer the types of jobs that fit your profile.
6. Write a report on your findings.

Chapter

5

JACOB LUND/SHUTTERSTOCK.COM

Small Business, Entrepreneurship, and Franchises

Why Should You Care?

America's small businesses drive the U.S. economy. Small businesses represent 99.9 percent of all employer firms, and there is a good probability that you will work for a small business or perhaps even start your own business. This chapter can help you become a good employee or a successful entrepreneur.

Learning Objectives

Once you complete this chapter, you will be able to:

5-1 Recognize the importance of small businesses to the U.S. economy.

5-2 Describe the kinds of people who start small businesses.

5-3 Describe the advantages and disadvantages of operating a small business.

5-4 Examine common reasons for small-business failure.

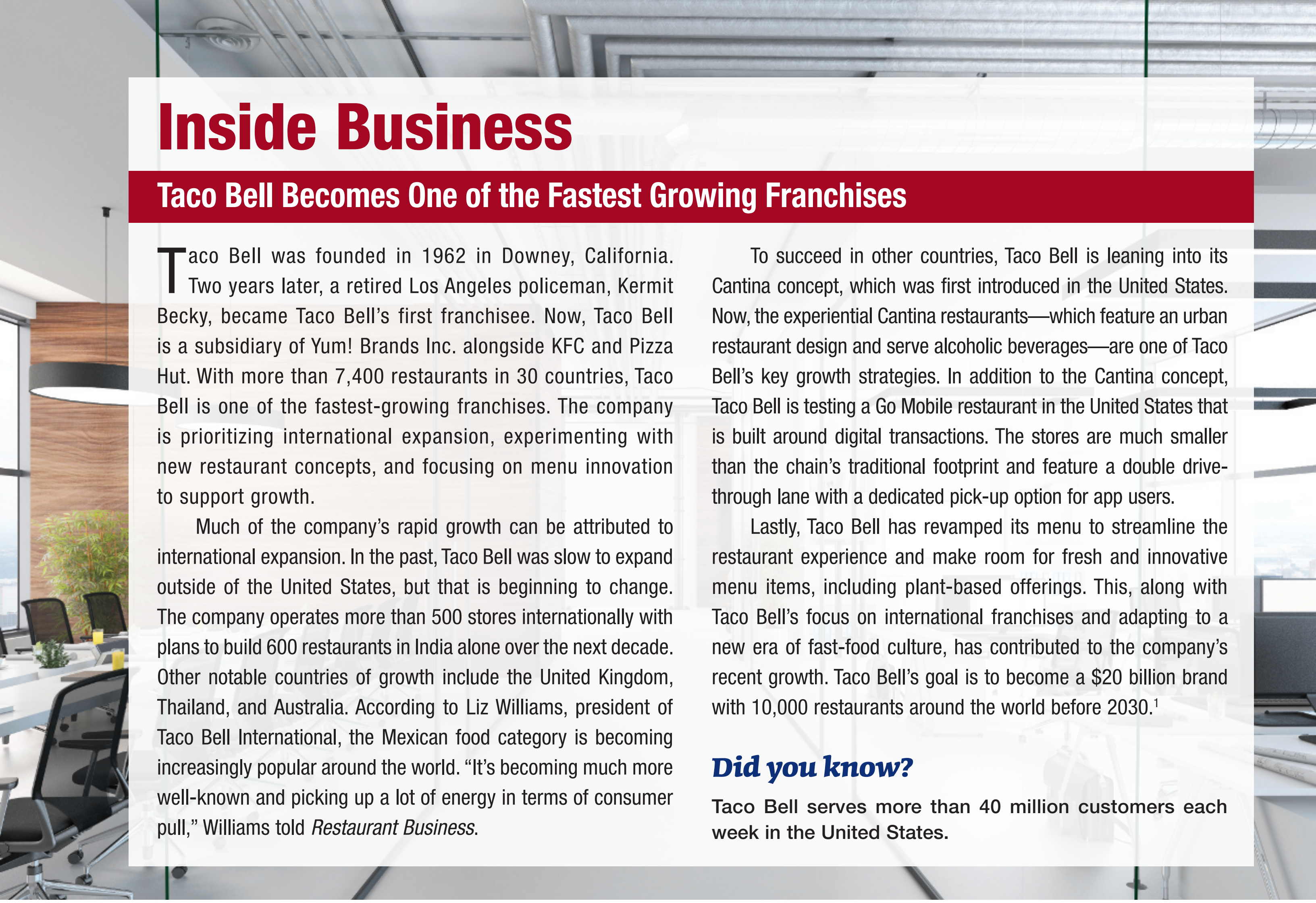
5-5 Discuss the importance of a business plan.

5-6 Explore franchising, including its types, growth, and advantages and disadvantages.

5-7 Describe methods entrepreneurs can use to finance their small business.

5-8 Explain how the Small Business Administration helps small businesses.

5-9 Explore how small businesses can take advantage of global markets.



Inside Business

Taco Bell Becomes One of the Fastest Growing Franchises

Taco Bell was founded in 1962 in Downey, California. Two years later, a retired Los Angeles policeman, Kermit Becky, became Taco Bell's first franchisee. Now, Taco Bell is a subsidiary of Yum! Brands Inc. alongside KFC and Pizza Hut. With more than 7,400 restaurants in 30 countries, Taco Bell is one of the fastest-growing franchises. The company is prioritizing international expansion, experimenting with new restaurant concepts, and focusing on menu innovation to support growth.

Much of the company's rapid growth can be attributed to international expansion. In the past, Taco Bell was slow to expand outside of the United States, but that is beginning to change. The company operates more than 500 stores internationally with plans to build 600 restaurants in India alone over the next decade. Other notable countries of growth include the United Kingdom, Thailand, and Australia. According to Liz Williams, president of Taco Bell International, the Mexican food category is becoming increasingly popular around the world. "It's becoming much more well-known and picking up a lot of energy in terms of consumer pull," Williams told *Restaurant Business*.

To succeed in other countries, Taco Bell is leaning into its Cantina concept, which was first introduced in the United States. Now, the experiential Cantina restaurants—which feature an urban restaurant design and serve alcoholic beverages—are one of Taco Bell's key growth strategies. In addition to the Cantina concept, Taco Bell is testing a Go Mobile restaurant in the United States that is built around digital transactions. The stores are much smaller than the chain's traditional footprint and feature a double drive-through lane with a dedicated pick-up option for app users.

Lastly, Taco Bell has revamped its menu to streamline the restaurant experience and make room for fresh and innovative menu items, including plant-based offerings. This, along with Taco Bell's focus on international franchises and adapting to a new era of fast-food culture, has contributed to the company's recent growth. Taco Bell's goal is to become a $20 billion brand with 10,000 restaurants around the world before 2030.[1]

Did you know?

Taco Bell serves more than 40 million customers each week in the United States.

Most businesses start small and those that survive usually stay small. However, businesses like Taco Bell provide a solid foundation for our economy—as employers, as suppliers and purchasers of goods and services, and as taxpayers. Small enterprise spans the gamut from corner newspaper vending to the development of robotic technologies and flying taxis. The owners of small businesses sell gasoline, flowers, and coffee to go. They publish magazines, haul freight, teach languages, and program computers. They make wines, movies, and high-fashion clothes. They build new homes and restore old ones. They fix appliances, recycle metals, and sell used cars. They drive cabs and fly planes. They make us well when we are ill, and they sell us the products of corporate giants. In fact, 74 percent of real estate, rental, and leasing industries; 61 percent of the businesses in the leisure and hospitality services; and 86 percent of the construction industries are dominated by small businesses.

In this chapter, we look closely at this important business sector—beginning with a definition of small business, the importance of small businesses in our economy, and a description of industries that often attract small businesses. Next, we provide a profile of the kinds of people who start small businesses. We also present the advantages and disadvantages of smallness in business and consider why small businesses may fail. We examine the importance and components of a business plan. We then discuss the pros and cons of franchising, an approach to small-business ownership that has become very popular in the last 60 years. We then describe how entrepreneurs can finance their businesses and get help from the Small Business Administration, a government agency formed to assist owners and managers of small businesses. We conclude the chapter with a brief look at the global opportunities for small businesses.

5-1 Small Business: a Profile

Learning Objective

5-1 Recognize the importance of small businesses to the U.S. economy.

The **Small Business Administration (SBA)**, created by Congress in 1953 to assist, counsel, and protect the interests of small businesses in the United States, defines a **small business** as "an independent business having fewer than 500 employees."[2] This is probably consistent with how you think of small businesses in your community. Consider the small independent coffee shop down the street, which probably has fewer than ten part-time employees and sells about $215,000 worth of coffee and pastries a year. Compare that to Starbucks, which has more than 32,000 locations worldwide and generates billions of dollars in revenue.[3] However, the SBA categorically defines smallness on the basis of the particular industry in which a business operates. Table 5-1 presents a sample of the SBA's "smallness" guidelines for various industries. Thus, number of employees and/or sales revenue may dictate size in a particular industry, and "small businesses" with more than 500 employees may still be viewed as small in some industries. On the other hand, 81 percent of small businesses have no employees at all, just the owner (the SBA refers to these as "nonemployers").[4] The SBA periodically revises and simplifies its small-business size regulations.

A business with annual sales in millions of dollars may not seem very small. However, for many firms, profit is only a small percentage of total sales. Consider an independent restaurant that brings in sales of $5 million in a year: once it has paid for ingredients and supplies, the wages of cooks and servers, as well as rent, utilities, taxes, and advertising and accounting expenses, the firm may earn only $50,000 or $60,000. Indeed, most small firms have annual sales well below the maximum limits in the SBA guidelines.

Table 5-1 Industry Group-Size Standards

Small-business size standards are usually stated in number of employees or average annual sales. The SBA has established two widely used size standards—500 employees for most manufacturing and mining industries and $7.5 million in average annual sales for many nonmanufacturing industries. In the United States, 99.9 percent of all businesses are considered small.

Industry Group	Size Standard
Manufacturing, mining industries	500–1,500 employees
Wholesale trade	100–250 employees
Agriculture	$750,000
Retail trade, barber shops, beauty salons	$7.5 million
General and heavy construction (except dredging)	$36.5 million
Dredging	$27.5 million
Special trade contractors	$15 million
Travel agencies, tour operators	$20.5 million
Department stores	$32.5 million
Discount stores	$29.5 million
Furniture stores	$20.5 million

Source: U.S. Small Business Administration, "Table of Small Business Size Standards Matched to North American Industry Classification System Codes," https://www.sba.gov/sites/default/files/files/Size_Standards_Table.pdf (accessed January 26, 2021).

Small Business Administration (SBA) a government agency that assists, counsels, and protects the interests of small businesses in the United States

small business an independent business with fewer than 500 employees, depending on its industry

5-1a The Small-Business Sector

In the United States, it typically takes less than a week and $600 to establish a business as a legal entity. The steps include registering the name of the business, applying for tax IDs, and setting up unemployment and workers' compensation insurance. In Japan, however, a typical entrepreneur spends more than $3,500 and 11 days to follow eight different procedures.

A surprising number of Americans take advantage of their freedom to start a business. There are, in fact, about 31.7 million businesses in this country. Only 20,139 of these employ more than 500 workers—enough to be considered large.[5]

Interest in owning or starting a small business has never been greater than it is today. During the last decade, the number of small businesses in the United States has increased 49 percent. However, about two-thirds of businesses launched between 1994 and 2018 survived at least two years. A little less than half survived five years or longer and just one-third of firms survived ten years or longer.[6] The makeup of the small-business sector thus is constantly changing. Despite the high failure rate, many small businesses succeed modestly. Some, like Apple Computer, Inc., are extremely successful—to the point where they can no longer be considered small.

5-1b The Importance of Small Business in Our Economy

Small businesses are vital to the U.S. economy. For example, small businesses:

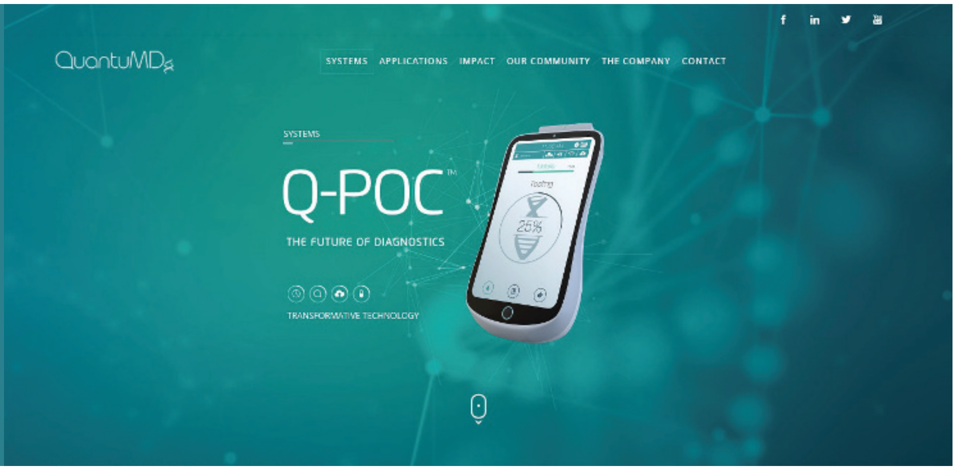
- represent 99.9 percent of all employer firms;
- employ about half of all private-sector employees;
- pay 40 percent of total U.S. private payroll;
- have generated 65 percent of net new jobs over the past 20 years; and
- made up 97.5 percent of all exporters and produced 32 percent of known export value.[7]

This country's economic history abounds with stories of ambitious entrepreneurs who turned their ideas into business dynasties. The Ford Motor Company started as a one-man operation with an innovative method for industrial production. L.L.Bean, Inc., can trace its beginnings to a basement shop in Freeport, Maine. Dell Computer started in Michael Dell's dorm room, while HP started in a California garage. Indeed, every year since 1963, the president of the United States has proclaimed National Small Business Week to recognize the contributions of small businesses to the economic well-being of America. Let's examine these a little closer.

Providing Technical Innovation Invention and innovation are part of the foundations of our economy. The increases in productivity that have characterized the past 200 years of our history are all rooted in one principal source: new ways to do a job with less effort for less money. Studies show that the incidence of innovation among small-business workers is significantly higher than among workers in large businesses. One such example is Colorado Springs-based Braxton Technologies, LLC, which provides hardware, software, and support services for satellites for defense and aerospace industry customers. The company recently received the prestigious Tibbitts Award from the SBA for excellence in innovation and research.[8]

According to the U.S. Office of Management and Budget, more than half the major technological advances of the 20th century originated with individual inventors and small companies. Even just a sampling of those innovations is remarkable:

- Air-conditioning
- Airplanes
- Automatic transmission
- FM radio



The future of diagnostics. QuantuMDx is a technology developer with a focus on delivering innovative diagnostic solutions to address global health inequality. The company, co-founded by CEO Elaine Warburton, is privately owned with a strong commercial and humanitarian focus.

SOURCE: QUANTUMDX

- Heart valves
- Helicopters
- Instant cameras
- Insulin
- Jet engines
- Penicillin
- Personal computers, and
- Power steering.

Perhaps even more remarkable—and important—is that many of these inventions sparked major new U.S. industries or contributed to an established industry by adding some valuable service.

Providing Employment Small firms traditionally have added more than their share of new jobs to the economy. Between 2000 and 2019, small businesses were responsible for 10.5 million net new jobs; in comparison, large companies created 5.6 million net new jobs.[9] In recent years, seven out of the ten industries that added the most new jobs were small-business-dominated industries such as business services, leisure and hospitality services, and special trade contractors. Small firms hire a larger proportion of employees who are younger workers, older workers, women, and workers who prefer to work part time. Moreover, it is small businesses that provide two-thirds of workers with their first jobs and initial on-the-job training in basic skills. According to the SBA, small businesses represent 99.9 percent of all employers, employ nearly half of the private sector workforce, and provide about two-thirds of the net new jobs added to our economy.

Providing Competition Small businesses challenge larger, established firms in many ways, causing them to become more efficient and more responsive to consumer needs. Consider Andy Dunn and Brian Spaly, who became frustrated at their inability to find pants that fit well, so they decided to design and sell their own. They launched Bonobos as a direct-to-consumer men's pants company, filling online orders out of Dunn's apartment. By focusing "maniacally" on the customer experience and offering innovative products, they quickly grew Bonobos into a million-dollar brand and expanded into men's and later women's apparel. Bonobos became one of the first internet companies to open brick-and-mortar stores, and ultimately was acquired by giant Walmart.[10] A small business cannot, of course, compete with a large firm in all respects. However, a number of small firms, each competing in its own particular area and its own particular way, together have the desired competitive effect. Thus, several small janitorial companies together add up to reasonable competition for the no-longer-small ServiceMaster.

Filling Needs of Society and Other Businesses Small firms also provide a variety of goods and services to consumers, to each other, and to much larger firms. General Motors relies on more than 32,000 companies for parts and supplies and depends on more than 11,000 independent dealers to sell its automobiles and trucks. Large firms generally buy parts and assemblies from smaller firms for one very good reason: It is less expensive than manufacturing the parts in their own factories. This lower cost eventually is reflected in the price that consumers pay for their products.

It is clear that small businesses are a vital part of our economy and that, as consumers and as members of the labor force, we all benefit enormously from their existence. Now let us look at the situation from the viewpoint of the owners of small businesses.

5-1c Industries That Attract Small Businesses

Some industries, such as auto manufacturing, require huge investments in machinery and equipment. Businesses in such industries are big from the day they are started—if an entrepreneur or group of entrepreneurs can gather the capital required to start one. By contrast, a number of other industries require only a low initial investment and some special skills or knowledge. It is these industries that tend to attract new businesses. Growing industries, such as outpatient-care facilities, are attractive because of their profit potential. However, knowledgeable entrepreneurs choose areas with which they are familiar, and these are most often the more established industries. The various kinds of businesses generally fall into three broad categories of industry: distribution, service, and production.

Distribution Industries This category includes retailing, wholesaling, transportation, and communications—industries concerned with the movement of goods from producers to consumers. Distribution industries account for approximately 33 percent of all small businesses. Of these, almost three-quarters are involved in retailing, that is, the sale of goods directly to consumers. Clothing and jewelry stores, pet shops, bookstores, and grocery stores, for example, are all retailing firms. Slightly less than one-quarter of the small distribution firms are wholesalers. Wholesalers purchase products in quantity from manufacturers and then resell them to retailers.

Service Industries This category accounts for more than 48 percent of all small businesses. Of these, about three-quarters provide such nonfinancial services as medical and dental care; watch, shoe, and TV repairs; haircutting and styling; restaurant meals; and dry cleaning. About 8 percent of the small service firms offer financial services, such as accounting, insurance, real estate, and investment counseling. An increasing number of self-employed Americans are running service businesses from home.

Production Industries This last category includes the construction, mining, and manufacturing industries. Only about 19 percent of all small businesses are in this group, mainly because these industries require relatively large initial investments. Small firms that do venture into production generally make parts and subassemblies for larger manufacturing firms or supply special skills to larger construction firms.

✓ Concept Check

- What information would you need to determine whether a particular business is small according to SBA guidelines?
- Describe four contributions of small business to the American economy.
- Distinguish among service industries, distribution industries, and production industries.

Exploring Careers

Tips for Aspiring Entrepreneurs

Becoming an entrepreneur can be rewarding, but it can be incredibly difficult to start and grow a business. Entrepreneurs who risk time, money, and effort to start and operate a business often do so in an attempt to bring a new idea to the market. However, it's not always about who is the first but rather who is the best. Today, the best businesses deliver the most value to consumers who have more power and choice than ever before.

It's not enough for business owners to create a product. Successful products solve a problem. Entrepreneurs often rely on professional experience to identify shortcomings in an industry. For example, Zoom's founder and CEO Eric Yuan was once the vice president of engineering for Cisco's Webex video conferencing business. He wasn't happy with the company's service, which often cut in and out and lacked various modern features. His calls to update the platform were ignored, so he left in 2010 to build and launch Zoom, a cloud-based video-conferencing tool of the future that prioritized customer needs. Today, Zoom is valued at nearly $100 billion.

Entrepreneurs should establish an authentic relationship with consumers. Brands have a compelling story to tell, and entrepreneurs should consider being the ones to tell that story. Many of the world's most successful entrepreneurs, such as Bill Gates (Microsoft), Oprah Winfrey (Harpo), Jeff Bezos (Amazon), Elon Musk (Tesla), Jack Ma (Alibaba), and Mark Zuckerberg (Facebook), are charismatic leaders. It's not necessary to become a full-fledged celebrity CEO, but a willingness to step into the spotlight to communicate with consumers can help individuals root for both the company and the entrepreneur behind it.

Original ideas often turn out to be not-so-original. This is because the market and cultural forces that inspire one entrepreneur are likely influencing another entrepreneur at the same time. For instance, rival ride-hailing companies Uber and Lyft were founded just a few years apart. The startup landscape can be incredibly competitive with multiple companies introducing similar products simultaneously. Entrepreneurs should consider how they can use their competitive advantage to solve problems in a way that delivers value to consumers.

Sources: Based on information in Emily Heyward, "So You Want to Be an Entrepreneur?" *Harvard Business Review*, July 23, 2020, www.hbr.org/2020/07/so-you-want-to-be-an-entrepreneur; Samantha Murphy Kelly, "Zoom's Massive 'Overnight Success' Actually Took Nine Years," *CNN*, March 27, 2020, www.cnn.com/2020/03/27/tech/zoom-app-coronavirus/index.html.

5-2 The People in Small Businesses: The Entrepreneurs

Learning Objective

5-2 Describe the kinds of people who start small businesses.

In Chapter 1, we defined entrepreneurs as people who risk their time, effort, and money to start and operate a business. As we've already shown, the entrepreneurial spirit is alive and well in the United States. Small businesses typically are managed by the people who started and own them, at least in their first years. Most of these people have held jobs with other firms and still could be so employed if they wanted. Yet owners of small businesses would rather take the risk of starting and operating their own firms, even if the money they make is less than the salaries they otherwise might earn. Researchers have suggested a variety of personal factors as reasons why people go into business for themselves. Let's take a look at them.

5-2a Characteristics of Entrepreneurs

Entrepreneurial spirit is the desire to create a new business. For example, Madeline Haydon saw that dairy-free coffee creamer options were limited and recognized an opportunity to introduce creamer products to satisfy consumers who are diabetic, lactose-intolerant, or simply want a plant-based product without artificial or genetically modified ingredients. Although she was warned not to proceed by

EUGENE GOLOGURSKY/GETTY IMAGES ENTERTAINMENT/GETTY IMAGES

LEMONADE
This way to discover
SOMETHING
SUPER FOR SIPPI

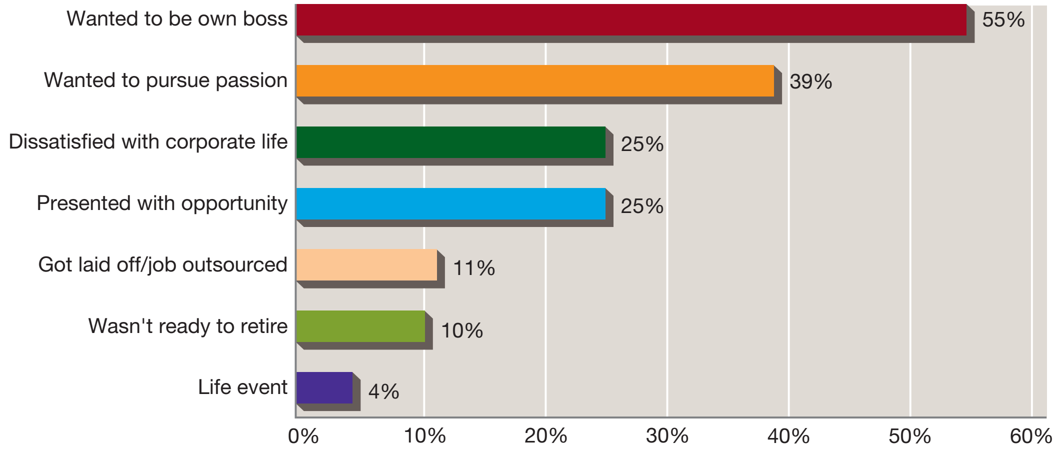
Sweet success. Mikaila Ulmer started a lemonade stand when she was just four years old to help her overcome a fear of bees, using her grandmother's recipe for honey-sweetened flaxseed lemonade. Now a teenager, Ulmer's Me & the Bees lemonade is sold in 1,500 stores and brings in millions of dollars in sales, some of which Ulmer's company donates to organizations working to save imperiled honeybee populations.

advisors with experience in the food industry, she started her company Nutpods and introduced dairy-free flavored and unsweetened creamers. Her customers loved the creamy products so much that Amazon named Nutpods its Small Business of the Year.[11]

Figure 5-1 lists some common reasons entrepreneurs give for wanting to start their own business. A majority say they simply have "had enough" of working and earning a profit for someone else. Others lost their jobs for some reason or saw them outsourced to another country and decided to start the business they had always wanted. Still others may have had an idea for a new product or a new way to sell an existing product, or the opportunity to go into business arose suddenly, perhaps as a result of a hobby. Christian Bok started Renova Medical Wear after seeing how hard it was for his mother to get dressed while recovering from surgery. His company now designs and makes dignified

Figure 5-1 What Motivates Entrepreneurs?

Entrepreneurs have many reasons for wanting to start a business, but these are the most common reasons.



Source: Small Business Trends Alliance survey, "Small Business Trends 2020," Guidant Financial, https://www.guidantfinancial.com/small-business-trends/ (accessed January 29, 2021).

and comfortable adaptive clothing for postsurgical patients to help make their recovery less stressful.[12]

In some people, the motivation to start a business develops slowly as they gain the knowledge and ability required for success as a business owner. Knowledge and ability—especially management ability—are probably the most important factors involved. A new firm is very much built around the entrepreneur. The owner must be able to manage the firm's finances, its personnel (if there are any employees), and its day-to-day operations. They must handle sales, advertising, purchasing, pricing, and a variety of other business functions. The knowledge and ability to do so are acquired most often through experience working for other firms in the same area of business.

Other factors that may influence a person to start a small business include

- independence;
- a desire to determine one's own destiny;
- a willingness to find and accept a challenge;
- family background (in particular, researchers think that people whose families have been in business, successfully or not, are most apt to start and run their own businesses); and
- age (those who start their own businesses also tend to cluster around certain ages—more than 70 percent are between 24 and 44 years of age).

5-2b **Women as Small-Business Owners**

According to American Express's *State of Women-Owned Business Report,* women today are starting 1,800 businesses *a day!* There are now nearly 13 million women-owned businesses (defined as being at least 51 percent owned, operated, and controlled by one or more women) that generate $1.9 trillion in revenues and provide jobs for 9.4 million workers. Although women make up 51 percent of the U.S. population, they own 42 percent of all businesses, up from 4.6 percent in 1972. The number of businesses owned by women of color has grown even more dramatically, and they now account for 50 percent of all women-owned businesses.[13] Of course, not all of these businesses are small, but most started out that way. Kendra Scott, for example, began designing jewelry in a guest bedroom after her first child was born. After 20 years of hard work, she grew her jewelry and home goods company to a $1 billion brand with more than 90 stores as well as an online shop.[14] About half of all small businesses are based out of the owner's home, and a majority of these are owned by women.

A significant number of women choose to start their own business because they have been unable to find a job, need a job with sufficient flexibility to allow them to care for family members, want to supplement their families' income, and/or want to capitalize on an opportunity they have recognized.[15] Consider Staci Pompey, who bought a sewing machine and launched a store on Etsy, an e-commerce site that focuses on handmade and vintage goods, to sell face masks during the COVID-19 pandemic. Aside from providing a much-needed product for consumers concerned about the virus, she generated significant extra income for her family while staying home to care for her children.[16]

Women entrepreneurs can turn to Women's Business Centers (WBCs), a network of nearly 100 educational centers throughout the United States. WBCs assist women in starting and growing small businesses and seek to "level the playing field" for women entrepreneurs, who still face unique obstacles in the business world. SBA's Office of Women's Business Ownership oversees the WBC Network, which provides entrepreneurs, especially women who are economically or socially disadvantaged, comprehensive training and counseling on business topics in several languages.[17]

Entrepreneurial Success

A Perfect Fit: How a Teen Landed a Deal with the Founder of TOMS

At the age of 15, Carson Grill was already running his own business. With the help of his father Jason Grill, Carson co-founded Touch Up Cup, a company selling paint storage containers. The father-son duo identified a problem and invented the solution. They came up with the idea for their product when they were painting their house. They opened old cans of paint to find rusty, clumpy, smelly paint. Carson invented the Touch Up Cup as a way to store a small amount of paint. The 13-ounce polypropylene container, which features a stainless-steel mixing ball for easy mixing, allows the paint to be saved for more than ten years.

Before its big break on ABC's *Shark Tank*, the product was already available online and in 4,000 retail locations, bringing in $220,000 in sales over two years. Carson, a long-time fan of the show, watched old episodes to perfect his pitch for the investors, upgraded the company's website to prepare for a rush of visitors, and ramped up inventory.

Carson already has four patents to his name: one utility patent for the Touch Up Cup and three design patents for additional storage products. Carson's knowledge of the business and entrepreneurial spirit caught the eye of several of the sharks, but it was guest shark Blake Mycoskie, the founder of TOMS, that had the winning offer. Mycoskie is a social entrepreneur, author, and philanthropist. The Grills accepted an offer from Mycoskie for a $175,000 investment for 17.5 percent equity.

The exposure alone from the Touch Up Cup's *Shark Tank* deal boosted company sales. The show led to thousands of new sales and opened the door for talks with major retailers. The company projected that the following year would bring $2 million in sales. Carson's entrepreneurial mind won't stop there. Next, he aims to make his food-saving products, called Fresh Line Keepers, just as successful.

Sources: Based on information in Taylor Locke, "'Shark Tank': How This 15-Year-Old Landed a 6-Figure Deal With the Founder of Toms," *CNBC*, www.cnbc.com/2020/10/19/shark-tank-how-teen-landed-business-deal-with-toms-founder.html; Touch Up Cup, "About Us," https://touchupcup.com/pages/aboutus; Liz Engel, "Cincinnati's 'Shark Tank' Teen Has Big Plans for 2021," *Cincinnati Business Courier*, December 23, 2020, www.bizjournals.com/cincinnati/news/2020/12/23/touch-up-cup-celebrates-shark-tank-success.html.

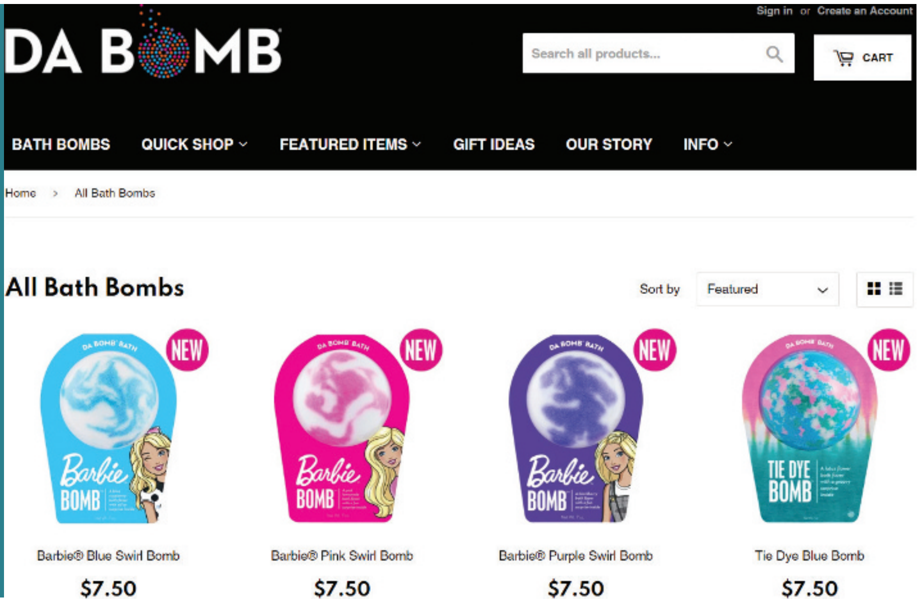
5-2c **Teenagers as Small-Business Owners**

Entrepreneurship among teens is also growing. Still, teen entrepreneurs face unique pressures in juggling their schoolwork, social life, and startup workload. Additionally, they may encounter difficulties with the legalities of starting and financing a business if their state requires company executives to be over age 18; further, banks often require applicants for credit or loans to be over 18. Some teen entrepreneurs ultimately quit school to run promising startups, whereas others quit or cut back on their business activities. Sisters Caroline Bercaw and Isabel Bercaw founded Da Bomb Bath Bombs before they were officially teenagers in Minneapolis, Minnesota. They made their bath bombs stand out by making them out of gentle ingredients and including a prize in the center. By the time they were 14 and 15 years old, their products were in 30 local stores; a year later, they were making 20,000 bath bombs a month in the basement of their home for national distribution. When discount chain Target asked the teens to supply 1,800 stores, they had to scale up quickly, so they enlisted their mom as chief executive. Today their business generates $20 million in revenue.[18]

5-2d **Immigrants as Entrepreneurs**

Jerry was born in Taiwan to parents who had fled there from China. His father died when he was very young, and his mother moved the family to the United States a few years later. Jerry learned English quickly and did well in school. While at Stanford University, he began creating websites as a hobby, including one about other websites that he called "Jerry's Guide to the World Wide Web." Within months, Jerry's Guide generated so much traffic that it became a burden for the computer infrastructure at Stanford; university officials requested he find another host. The name of the website was later changed to Yahoo! Jerry—whose full name is Jerry Yang—co-founded Yahoo with David Filo; they incorporated, obtained venture capital, and began hiring employees. At one point, the

Bath bombs are da bomb. Carline Bercaw and Isabel Bercaw turned their love of using and creating fun bath bombs into a $20 million family business when they were still teens.



SOURCE: DA BOMB

value of Yahoo peaked at more than $100 billion, and the personal wealth of Jerry Yang exceeds $2 billion today, though he is no longer with the company he founded.[19]

Jerry Yang's story is far from unique. More than half of U.S. startups that became billion-dollar companies have an immigrant founder or top executive, including Uber, Warby Parker, Slack, Stripe, Credit Karma, Discord, Eventbrite, Evernote, Zoom, Peloton, and ZocDoc. Moreover, it is estimated that immigrants are responsible for a quarter of invention and entrepreneurship in the United States.[20] Entrepreneurship has been growing among immigrants like Jerry Yang. The SBA estimates that one out of every six American businesses with employees is owned by an immigrant.[21]

✓ Concept Check

- What kinds of factors encourage people to start new businesses?
- What kinds of people start businesses?

5-3 The Pros and Cons of Smallness

Learning Objective

5-3 Describe the advantages and disadvantages of operating a small business.

Do most owners of small businesses dream that their firms will grow into giant corporations—managed by professionals—while they serve only on the board of directors? Or would they rather stay small, in a firm where they have the opportunity (and the responsibility) to do everything that needs to be done? The answers depend on the personal characteristics and motivations of the individual owners. For many, the advantages of remaining small far outweigh the disadvantages.

5-3a Advantages of Small Businesses

Small-business owners with limited resources often must struggle to enter competitive new markets. They also have to deal with increasing international competition. However, they enjoy several unique advantages.

Personal Relationships with Customers and Employees For those who like dealing with people, small business is the place to be. The owners of retail shops get to know many of their customers by name and deal with them on a personal basis. Through such relationships, small-business owners often become involved in the social, cultural, and political life of the community. Relationships between owner-managers and employees also tend to be closer in smaller businesses. In many cases, the owner is a friend and counselor as well as the boss.

These personal relationships provide an important business advantage. The personal service small businesses offer to customers is a major competitive weapon—one that larger firms try to match but often cannot. In addition, close relationships with employees often help the small-business owner to keep effective workers who might earn more with a larger firm.

Ability to Adapt to Change Being their own boss, small-business owner-managers do not need anyone's permission to adapt to change. An owner may add or discontinue merchandise or services, change store hours, and experiment with various price strategies in response to changes in market conditions. And through personal relationships with customers, the owners of small businesses quickly become aware of changes in people's needs and interests, as well as in the activities of competing firms. Although the COVID-19 pandemic devastated small businesses and caused many to fail, others blossomed by adapting in creative ways. As an example, Atlanta entrepreneur Eric Levitan had started Vivo to provide strength-training workouts in communities for adults 55 and over after observing his parents struggle with mobility and aging challenges. When the pandemic made in-person classes impossible, he pivoted and began offering classes via Zoom with a live instructor. Although Vivo is still quite small, the pandemic in fact expanded his potential market to older adults around the world.[22]

Simplified Record Keeping Many small firms need only a simple set of records. Record keeping might consist of a checkbook, a cash-receipts journal in which to record all sales, and a cash-disbursements journal in which to record all amounts paid out. More often, entrepreneurs today use software designed for small-business finances or outsource bookkeeping and personnel tasks to other small businesses that are experts in them. Obviously, small-business owners must maintain sufficient records to allow for producing and filing accurate tax returns.

Independence Small-business owners do not have to punch in and out, compete for vacation times, take orders from superiors, or worry about being fired or laid off. They are the masters of their own destinies—at least with regard to employment. For many people, this is the prime advantage of owning a small business.

Additional Advantages Small-business owners also enjoy all the advantages of sole proprietorships, which were discussed in Chapter 4. These include being able to keep all profits, the ease and low cost of going into business and (if necessary) going out of business, and being able to keep proprietary information private.

MONKEY BUSINESS IMAGES/SHUTTERSTOCK.COM

Getting personal. For those who like dealing with people, small business is the place to be. Here a business owner provides personalized service to a happy customer.

5-3b **Disadvantages of Small Businesses**

Personal contacts with customers, closer relationships with employees, being your own boss, less cumbersome record-keeping chores, and independence are the bright side of small business. In contrast, the dark side reflects problems unique to these firms.

Risk of Failure As we have noted, small businesses (especially new ones) run a heavy risk of going out of business—only about 50 percent survive at least five years. Even older, well-established small firms can be hit hard by an economic downturn if they do not have the financial resources to weather an extended difficult period.

Limited Potential Small businesses that survive do so with varying degrees of success. Many are simply the means of making a living for owners and their families. The owner may have some technical skill—as a hair stylist or electrician, for example—and may have started a business to put this skill to work. Such a business is unlikely to grow into big business. In addition, employees' potential for advancement is limited.

Limited Ability to Raise Capital Small businesses typically have a limited ability to obtain capital. Most small-business financing (64 percent) comes out of the owner's pocket or from family savings. Business loans from lending institutions provide only about one-sixth of the capital required by small businesses. A surprising amount of financing comes from personal credit cards (9 percent).[23] About half of all new firms begin with less than $30,000 in total capital, according to Census Bureau and Federal Reserve surveys. In fact, almost 36 percent of new firms begin with less than

Technology and Innovation

COVID-19 Challenges American Innovation

Hundreds of thousands of small businesses closed permanently as a result of the COVID-19 pandemic. It's estimated that 110,000 businesses in the restaurant industry alone closed permanently due to the global crisis and resulting recession. When fewer small businesses exist, there is less innovation and entrepreneurship, two elements that characterize the United States.

The percentage of firms with fewer than 100 employees has been declining since the 1980s, a trend accelerated by the pandemic. Larger businesses had more resources to fight the pandemic. The number of bankruptcy filings among public companies was far below the numbers reached during the Global Recession. Simply put, small businesses have fewer financial resources available to them. Bank loans are the top source of outside financing for small businesses, yet 70 percent of senior loan officers reported to the Federal Reserve that they were tightening lending standards for small firms during the COVID-19 crisis. Though many small businesses benefited from the government's Paycheck Protection Program, for some the funds came too late and for others, the funds didn't stretch far enough. Large, public companies, on the other hand, had ready access to capital markets for funding.

Though life began to return to normal for many individuals in the year following the pandemic, the damage done to small businesses is likely to have long-lasting effects. Small businesses that grow to become larger firms significantly contribute to job growth for the U.S. economy. But, with so many businesses now closed for good, there are fewer companies that will grow to become major employers, slowing the speed of economic recovery. Additionally, with fewer small businesses, larger firms have less competition and therefore less motivation to innovate. This also means there will be fewer small firms for acquisition, which is a significant way large companies expand and improve their product offerings.

The pandemic changed the dynamics of business in America. Many small businesses, which had fewer financial resources than large firms, suffered disproportionately. Though many business owners were able to adapt to survive, a significant portion were not. This decrease in entrepreneurship will have a lasting effect on American innovation.

Sources: Based on information in Justin Lahart, "Covid Is Crushing Small Businesses. That's Bad News for American Innovation," *The Wall Street Journal*, October 9, 2020, www.wsj.com/articles/covid-is-crushing-small-businesses-thats-bad-news-for-american-innovation-11602235804; Carolina Gonzalez, "Restaurant Closings Top 110,000 with Industry in 'Free Fall'," *Bloomberg*, December 7, 2020, www.bloomberg.com/news/articles/2020-12-07/over-110-000-restaurants-have-closed-with-sector-in-free-fall.

$20,000, usually provided by the owner or family members and friends.[24] According to the SBA, average capital for starting a new business is $80,000.

Although every person who considers starting a small business should be aware of the hazards and pitfalls we have noted, a well-conceived business plan may help to avoid the risk of failure. The U.S. government is also dedicated to helping small businesses make it. It expresses this aim most actively through the SBA.

✓ Concept Check

- What are the major advantages of smallness in business?
- What are the major disadvantages of smallness?

5-4 Why Some Entrepreneurs and Small Businesses Fail

Learning Objective

5-4 Examine common reasons for small-business failure.

Every day, and in every part of the country, people open new businesses. Table 5-2 shows the number of businesses that opened and the number of business that closed in a year. Although many businesses fail, others thrive due to well-conceived ideas developed by entrepreneurs with the expertise, resources, and determination to make their businesses succeed. As these well-prepared entrepreneurs pursue their individual goals, our society benefits in many ways from their work and creativity.

The reality is that small businesses are prone to failure. Funding, management, and planning are the key ingredients in the survival of a small business, and the lack of these are the most common reasons for failure. Businesses can experience a number of money-related problems. It may take several years before a business begins to show a profit. Entrepreneurs need to have not only the capital to open a business but also the money to operate it in its possibly lengthy start-up phase. One cash flow obstacle often leads to others. Moreover, a series of cash flow predicaments usually ends in a business failure. This scenario is played out all too often by small and not-so-small start-up internet firms that fail to meet their financial backers' expectations and so are denied a second wave of investment dollars to continue their drive to establish a profitable online firm.

Starting a small business also requires much more than optimism and a good idea. Many entrepreneurs lack the management skills required to run a business successfully. Money, time, personnel, and inventory all need to be managed effectively if a small business is to succeed. Even businesses that survive may have trouble expanding. Frequently, entrepreneurs with successful small businesses make the mistake of overexpansion. Fast growth often results in dramatic changes in a business. Thus, the entrepreneur must plan carefully and adjust competently to new and potentially disruptive situations.

✓ Concept Check

- What are the major causes of small-business failure?
- Do these causes also apply to larger businesses?

Table 5-2 U.S. Employer Business Start-ups and Closures

	New (In Thousands)	Closures (In Thousands)
2016	433	400
2015	414	396
2014	404	392
2013	404	367
2012	409	362
2011	398	404
2010	385	417
2009	406	486
2008	488	471

Source: U.S. Small Business Administration, Office of Advocacy, "Frequently Asked Questions," September 2019, https://cdn.advocacy.sba.gov/wp-content/uploads/2019/09/24153946/Frequently-Asked-Questions-Small-Business-2019-1.pdf (accessed February 4, 2021).

5-5 The Importance of a Business Plan

Learning Objective

5-5 Discuss the importance of a business plan.

Lack of planning can be as deadly as lack of money to a new small business. Planning is important to any business, large or small, and never should be overlooked or taken lightly. A **business plan** is a carefully constructed guide for the person starting a business. Jeff Bezos drafted a business plan for an online bookseller while on a cross-country road trip. It helped him convince family members and friends to invest in what would become Amazon, now a $1.7 trillion company.[25]

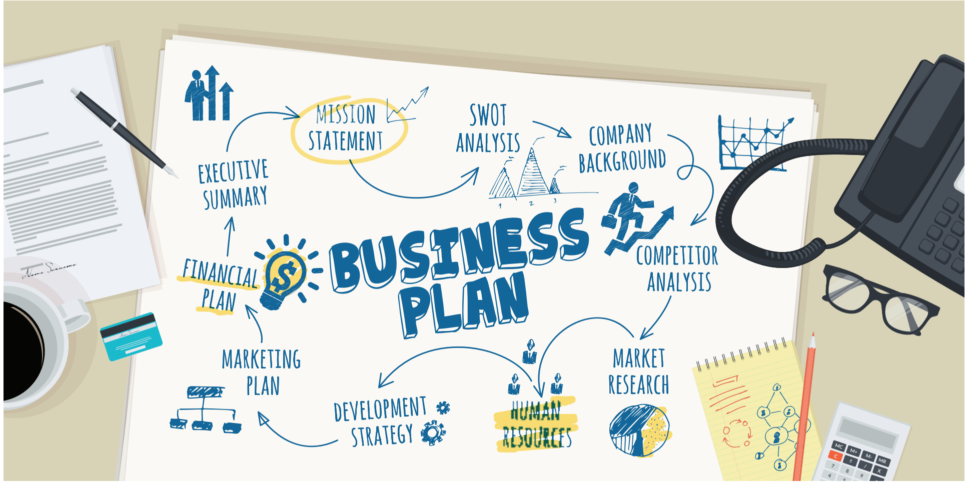
Consider the business plan a tool with three basic purposes: communication, management, and planning. As a communication tool, a business plan serves as a concise document that potential investors can examine to see if they would like to invest or assist in financing a new venture. It shows whether a business has the potential to make a profit. As a management tool, the business plan helps track, monitor, and evaluate the progress. The business plan is a living document; it is modified as the entrepreneur gains knowledge and experience. It also serves to establish timelines and milestones and allows comparison of growth projections against actual accomplishments. Finally, as a planning tool, the business plan guides a businessperson through the various phases of business. For example, the plan helps to identify obstacles to avoid and to establish alternatives.

Table 5-3 lists the 12 sections that a business plan should include. Each section is further explained at the end of each of the six major parts in this textbook. The goal of each of these end-of-the-part exercises is to help businesspeople create their own business plans. When constructing a business plan, the entrepreneur should strive to keep it easy to read, uncluttered, and complete. Like other busy executives, officials of financial institutions do not have the time to wade through pages of extraneous data. The business plan should answer the four questions banking officials and investors are most interested in: (1) What exactly is the nature and mission of the new venture? (2) Why is this new enterprise a good idea? (3) What are the businessperson's goals? (4) How much will the new venture cost?

The great amount of time and consideration that should go into creating a business plan probably will end up saving time later. For example, Sharon Burch, who was running a computer software business while earning a degree in business administration, had to write a business plan as part of one of her courses. Burch has said, "I wish I'd taken the class before I started my business. I see a lot of things I could have done differently. But it has helped me since because I've been using the business plan as a guide for my business." Accuracy and realistic expectations are crucial to an effective business plan. It is unethical to deceive loan officers, and it is unwise to deceive yourself.

✓ Concept Check

- Why is a business plan important?
- What are the major components of a business plan? Why should an individual develop a business plan?



PURESOLUTION/SHUTTERSTOCK.COM

business plan a carefully constructed guide for the person starting a business

Table 5-3 Components of a Business Plan

1. *Introduction*. Basic information such as the name, address, and phone number of the business; the date the plan was issued; and a statement of confidentiality to keep important information away from potential competitors.
2. *Executive Summary.* A one- to two-page overview of the entire business plan, including a justification why the business will succeed.
3. *Benefits to the Community*. Information on how the business will have an impact on economic development, community development, and human development.
4. *Company and Industry*. The background of the company, choice of the legal business form, information on the products or services to be offered, and examination of the potential customers, current competitors, and the business's future.
5. *Management Team.* Discussion of skills, talents, and job descriptions of management team, managerial compensation, management training needs, and professional assistance requirements.
6. *Manufacturing and Operations Plan*. Discussion of facilities needed, space requirements, capital equipment, labor force, inventory control, and purchasing requirement.
7. *Labor Force*. Discussion of the quality of skilled workers available and the training, compensation, and motivation of workers.
8. *Marketing Plan*. Discussion of markets, market trends, competition, market share, pricing, promotion, distribution, and service policy.
9. *Financial Plan*. Summary of the investment needed, sales and cash flow forecasts, breakeven analysis, and sources of funding.
10. *Exit Strategy*. Discussion of a succession plan or going public. Who will take over the business?
11. *Critical Risks and Assumptions*. Evaluation of the weaknesses of the business and how the company plans to deal with these and other business problems.
12. *Appendix*. Supplementary information crucial to the plan, such as résumés of owners and principal managers, advertising samples, organization chart, and any related information.

Source: From HATTEN, *Small Business Management,* 5E.

5-6 Franchising

Learning Objective

5-6 Explore franchising, including its types, growth, and advantages and disadvantages.

Although many entrepreneurs choose to start a business from scratch, others have found a different path to success. Entrepreneurs can purchase an existing business from an owner looking to move on. Another option is acquiring a **franchise**, a license to operate an individually owned business as if it were part of a chain of outlets or stores. Often, the business itself is also called a *franchise*. Among the most familiar franchises are McDonald's, Kumon, Planet Fitness, ACE Hardware, and KFC. Many other franchises carry familiar names; this method of doing business has become very popular in the last 60 years or so. It can be an attractive means of starting and operating a small business.

5-6a What Is Franchising?

Franchising is the actual granting of a franchise. A **franchisor** is an individual or organization granting a franchise. A **franchisee** is a person or organization purchasing a franchise. The franchisor supplies a known and advertised business name, management skills, the required training and materials, and a method of doing business. The franchisee supplies labor and capital, operates the franchised business, and agrees to abide by the provisions of the franchise agreement. Table 5-4 lists the basic franchisee rights and obligations that would be covered in a typical franchise agreement.

franchise a license to operate an individually owned business as though it were part of a chain of outlets or stores

franchising the actual granting of a franchise

franchisor an individual or organization granting a franchise

franchisee a person or organization purchasing a franchise

Table 5-4 Basic Rights and Obligations Delineated in a Franchise Agreement

Franchisee rights include:

1. Use of trademarks, trade names, and patents of the franchisor;
2. Use of the brand image and the design and decor of the premises developed by the franchisor;
3. Use of the franchisor's secret methods;
4. Use of the franchisor's copyrighted materials;
5. Use of recipes, formulae, specifications, processes, and methods of manufacture developed by the franchisor;
6. Conducting the franchised business upon or from the agreed premises strictly in accordance with the franchisor's methods and subject to the franchisor's directions;
7. Guidelines established by the franchisor regarding exclusive territorial rights; and
8. Rights to obtain supplies from nominated suppliers at special prices.

Franchisee obligations include:

1. To carry on the business franchised and no other business upon the approved and nominated premises;
2. To observe certain minimum operating hours;
3. To pay a franchise fee;
4. To follow the accounting system laid down by the franchisor;
5. Not to advertise without prior approval of the advertisements by the franchisor;
6. To use and display such point-of-sale advertising materials as the franchisor stipulates;
7. To maintain the premises in good, clean, and sanitary condition and to redecorate when required to do so by the franchisor;
8. To maintain the widest possible insurance coverage;
9. To permit the franchisor's staff to enter the premises to inspect and see if the franchisor's standards are being maintained;
10. To purchase goods or products from the franchisor or its designated suppliers;
11. To train the staff in the franchisor's methods to ensure that they are neatly and appropriately clothed; and
12. Not to assign the franchise contract without the franchisor's consent.

Source: Office of Entrepreneurship Education Resources, https://www.sba.gov/offices/headquarters/oee/resources/3641 (accessed February 5, 2021).

5-6b The Growth of Franchising

Franchising, which began in the United States around the time of the Civil War, was originally used by large firms, such as the Singer Sewing Company, to distribute their products. Franchising has been increasing steadily in popularity since the early 1900s, primarily for service stations and car dealerships; however, growth has escalated since the mid-1970s. The proliferation of franchises generally has paralleled the expansion of the fast-food industry. Of course, franchising is not limited to fast foods. Hair salons, tanning parlors, and dentists and lawyers are participating in franchising arrangements in growing numbers. Franchised health clubs, pest exterminators, and campgrounds are already widespread, as are franchised tax preparers and travel agencies. The real estate industry also has experienced a rapid increase in franchising. Franchising is also growing outside the United States.

McDonald's
McDonald's
CASINO ROYALE
GET YOUR SHARE
20 NUGGETS $6.29
PANDA EXPRESS CHINESE KITCHEN
CHIPOTLE MEXICAN GRILL
NEW YORK PIZZA
VENETIAN

KIT LEONG/SHUTTERSTOCK.COM

The growth of franchising. Franchising is designed to provide a tested formula for success, along with ongoing advice and training. The franchisor, such as McDonald's or Panda Express, supplies a known and advertised business name, management skills, the required training and materials, and a method of doing business. Franchising, however, is not a guarantee of success for either franchisees or franchisors.

Moreover, franchising is attracting more women and people of color than ever before. As an example, Michelle Lewis quit her full-time job to open a store through the Painting with a Twist franchise, which offers customers the ability to socialize while creating art. When her store became successful, she opened two more stores in the Detroit area with her sister, and now oversees 30 employees.[26] Unlike starting a business from scratch, franchising can offer franchisees from underrepresented groups greater access to business connections and support. Indeed, many franchisors such as Wendy's, McDonald's, Burger King, and Church's Chicken have special corporate programs to attract underrepresented groups and women as franchisees. Just as important, successful women and underrepresented franchisees are willing to get involved by offering advice and guidance to new franchisees. Herman Petty, the first Black McDonald's franchisee, says that the company provided significant help while he worked to establish his first store in 1968. In turn, Petty traveled to help other Black franchisees, eventually organizing a support group, the National Black McDonald's Operators Association, to help Black franchisees in other areas. Today, members of this association own McDonald's restaurants throughout the United States, South Africa, and the Caribbean.[27]

5-6c Types of Franchising

Franchising arrangements fall into three general categories. In the first approach, a manufacturer authorizes a number of retail stores to sell a certain brand-name item. This type of franchising arrangement, one of the oldest, is prevalent in sales of passenger cars and trucks, farm equipment, shoes, paint, earth-moving equipment, and petroleum. About 90 percent of all gasoline is sold through franchised, independent retail service stations, and franchised dealers handle virtually all sales of new cars and trucks.

In the second type of franchising arrangement, a producer licenses distributors to sell a given product to retailers. This arrangement is common in the soft drink industry. National manufacturers of soft drink syrups—the Coca-Cola Company and PepsiCo—franchise independent bottlers who then serve retailers.

Sustaining the Planet

Inside Oxi Fresh's Franchise Growth

Oxi Fresh Carpet Cleaning uses innovative, environmentally friendly products to offer greener carpet cleaning services. The Denver-based company's cleaning method requires only two gallons of water per home compared to the 40 to 50 gallons many other steam cleaners require. With 450 locations in the United States and Canada, the company has been ranked as one of the top growth franchises by *Entrepreneur*.

Oxi Fresh's history is characterized by rapid expansion. It was founded in 2006 by Jonathan Barnett with a single location. Barnett, who owned an International Basketball League franchise called the Colorado Crossover, used his experience with franchising and his experience in carpet cleaning to open the first Oxi Fresh location. Within just six months, Barnett grew the company to 17 locations in five states. In 2014, the company expanded outside of the United States for the first time as it entered Canada. Today, the company has completed more than one million cleanings across its 450 locations.

In addition to growth, Oxi Fresh has been recognized for franchisee satisfaction. The company focuses on providing its franchisees with the tools they need to succeed, such as training materials, an easy-to-use online scheduling tool, business management systems, and email marketing. For example, the company uses a customer relationship management (CRM) system that helps franchisees to manage schedules, track return on investment for marketing investments, complete payroll, and manage customers. Additionally, the company hosts a national convention to connect with franchisees and share best practices.

The home services franchise category as a whole is experiencing significant gains, which demonstrates the strength of the industry. Oxi Fresh has found there is increasing demand for greener carpet cleaning services. In addition to selling a more sustainable product, Oxi Fresh contributes in other ways to sustaining the planet. Every time a customer books a carpet cleaning service through Oxi Fresh's online scheduler, the company makes a donation to Water.org, a nonprofit that is fighting the global water crisis. As one of the greenest carpet cleaning franchises in the United States, Oxi Fresh is poised for growth.

Sources: Based on information in "Oxi Fresh Carpet Cleaning Poised for Enormous Growth in 2021," *Yahoo! Finance*, February 25, 2021, https://finance.yahoo.com/news/oxi-fresh-carpet-cleaning-poised-220600290.html; "Oxi Fresh Carpet Cleaning Ranked as Top Growth Franchise by Entrepreneur Magazine," *Franchising.com*, September 23, 2020, www.franchising.com/news/20200923_oxi_fresh_carpet_cleaning_ranked_as_top_growth_franchise_by_entrepreneur_ma.html; Oxi Fresh Carpet Cleaning, "History," www.oxifresh.com/carpet-cleaning-companies/history; Annie Pilon, "In the Spotlight: Oxi Fresh Clears the Air About What Sets It Apart from other Carpet Cleaners," *Small Business Trends,* May 22, 2019, www.smallbiztrends.com/2019/05/fast-drying-carpet-cleaner-oxi-fresh.html.

In a third form of franchising, a franchisor supplies brand names, techniques, or other services rather than a complete product. Although the franchisor may provide certain production and distribution services, its primary role is the careful development and control of marketing strategies. This approach to franchising, which is the most typical today, is used by Orange Therapy, Hampton Inn, 7-Eleven Inc., Anytime Fitness, Denny's Inc., Pizza Hut Inc., Dunkin', and Subway, to name but a few.

Dual-branded franchises, in which two franchisors offer their products together, are a new small-business trend. FAT Brands, for example, has been opening co-branded Fatburger and Buffalo's Express stores.[28]

5-6d Advantages of Franchising

Franchising plays a vital role in our economy. Why? Because franchising offers advantages to both the franchisor and the franchisee.

To the Franchisor The franchisor gains fast and well-controlled distribution of its products without incurring the high cost of constructing and operating its own outlets. The franchisor thus has more capital available to expand production and to use for advertising. At the same time, it can ensure, through the franchise agreement, that outlets are maintained and operated according to its own standards. The franchisor also benefits from the fact that the franchisee—a sole proprietor in

JEFFREY ISAAC GREENBERG 15+/ALAMY STOCK PHOTO

The Peterbrooke Chocolatier story. Peterbrooke Chocolatier has been making gelato and handmade treats like chocolate sushi rolls and seasonal chocolate molds for nearly 40 years. Since then, the firm has grown from a small Jacksonville, Florida, shop into an award-winning company. Franchises are now located throughout the Southeastern United States.

most cases—is likely to be highly motivated to succeed. The success of the franchise means more sales, which translate into higher royalties for the franchisor.

To the Franchisee The franchisee gets the opportunity to start a business with limited capital and to make use of the business experience of others. Moreover, an outlet with a nationally advertised name, such as Dunkin', McDonald's, or Great Clips, has guaranteed customers as soon as it opens. If business problems arise, the franchisor gives the franchisee guidance and advice. This counseling is primarily responsible for the high degree of success enjoyed by franchises. In most cases, the franchisee does not pay for such help. As an example, Taco Bell provides franchisees with classroom and on-the-job training, proprietary software, online and toll-free support, and an intranet for franchisees.[29]

The franchisee also receives materials to use in local advertising and can take part in national promotional campaigns sponsored by the franchisor. McDonald's and its franchisees, for example, are among the nation's top 30 advertisers. Finally, the franchisee may be able to minimize the cost of advertising, supplies, and various business necessities by purchasing them in cooperation with other franchisees.

5-6e Disadvantages of Franchising

The main disadvantage of franchising affects the franchisee, and it arises because the franchisor retains a great deal of control. The franchisor's contract can dictate every aspect of the business: decor, design of employee uniforms, types of signs, required menu items, and all the details of business operations. All Burger King french fries taste the same because all Burger King franchisees have to make them the same way.

Disputes over franchise contracts are the cause of many lawsuits. In one case, a group of U.S. franchisees of Canadian fast-food restaurant chain Tim Hortons sued the franchisor, alleging the company charged them unfairly high prices on food and supplies required to operate their restaurants after it had received rebates from those suppliers. The lawsuit also contends that Tim Hortons's parent company owns the suppliers that the franchisees are required to use, further enriching the company at the franchisees' expense.[30] In another case, H&R Block filed suit against a former franchisee for flouting a noncompete agreement and continuing to use the H&R Block brand after his franchise agreement had been terminated due to his failure to pay royalties.[31]

DARYA KAUFMAN/SHUTTERSTOCK.COM

Even success can cause problems. Sometimes a franchise is so successful that the franchisor opens its own outlet nearby, in direct competition—although franchisees may fight back. For example, a court ruled that Burger King could not enter into direct competition with a franchisee because the contract was not specific on the issue. A spokesperson for one franchisor contends that the company "gives no geographical protection" to its franchise holders and thus is free to move in on them.

Franchise holders pay for their security, usually with a onetime franchise fee and continuing royalty and advertising fees, collected as a percentage of sales. For example, a Subway franchisee pays an initial franchise fee of $15,000 and fee of 12.5 percent of gross sales (8 percent royalty and 4.5 percent advertising fees). In some fields, franchise agreements are not uniform. One franchisee may pay more than another for the same services.

Franchise operators work hard. They often put in 10- and 12-hour days, six days a week. The International Franchise Association advises prospective franchise purchasers to investigate before investing and to approach buying a franchise cautiously. Franchises vary widely in approach as well as in products. Some, such as Dunkin' and Baskin-Robbins, require long hours. Others, such as Great Clips and SportClips hair salons, are more appropriate for those who do not want to spend so many hours at their stores.

✓ Concept Check

- Explain the relationships among a franchise, the franchisor, and the franchisee.
- Describe the three general categories of franchising arrangements.
- Cite one major benefit of franchising for the franchisor. Cite one major benefit of franchising for the franchisee.

5-7 Financing the Small Business

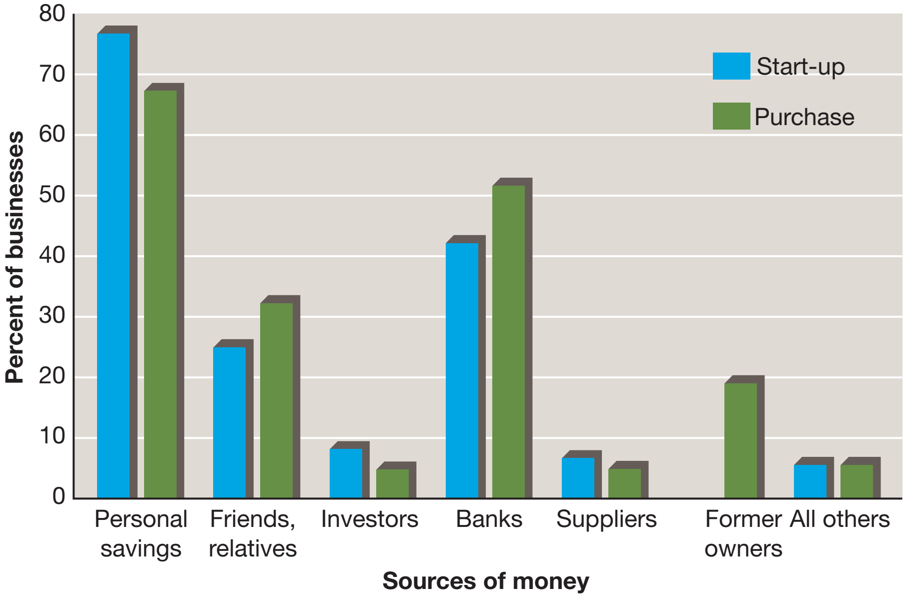
Learning Objective

5-7 Describe methods entrepreneurs can use to finance their small business.

After deciding whether to start from scratch or purchase an existing business or franchise, an entrepreneur must determine how to finance the startup. As mentioned earlier, most entrepreneurs start their businesses using their own personal savings and assets (Figure 5-2). Many borrow from friends and family members, even though that could lead to friction in relationships down the road. Others max out their credit cards. Some firms are able to secure grants from government or nonprofit sources, but these are usually for relatively small amounts and often require complex application processes. Beyond these resources, an entrepreneur generally has two sources of funding: debt and equity.

Figure 5-2 Sources of Capital for Entrepreneurs

Small businesses get financing from various sources; the most important is personal savings.



Source: Data developed and provided by the National Federation of Independent Business Foundation and sponsored by the American Express Travel Related Services Company, Inc.

5-7a Equity Financing

Equity financing involves raising funds by promising investors a share of future profits and an ownership stake in the business. Other than equity financing through family and friends, entrepreneurs often seek out **venture capital**—money that is invested in small (and sometimes struggling) firms that have the potential to become successful. In many cases, only a lack of capital keeps these firms from rapid and solid growth. The organizations that invest in these promising firms expect that their investments will grow with the firms and become quite profitable. Consider Serena Ventures, which strives to invest in startups that "are changing the world with their ideas and products." Founded by tennis ace Serena Williams, the firm focuses its resources on startups founded by people of color, women, and younger entrepreneurs who often face extra challenges raising funds. Among Serena Ventures' investment success stories are Tonal, Billie, Olly, Propel, and Noom.[32] A small business with a track record of success can also pursue *angel investors*, private individuals who invest money in exchange for ownership in the company. The angel investor at some point hopes to sell their ownership stake for a profit.

Venture and angel capital are a relatively small part of business financing. While the average venture capital investment has increased significantly in recent years, the smallest firms still have difficulty obtaining venture capital, especially those owned by women and people of color. To help such businesses, the Small Business Administration licenses, regulates, and provides financial assistance to **small-business investment companies (SBICs),** which are privately owned firms that provide venture capital to small enterprises that meet their investment standards. Firms such as Apple, Costco, Whole Foods, FedEx, Intel, and Staples all received financing through SBICs during their initial growth period. The 314 SBICs are intended to be profit-making organizations. The aid that SBA offers allows them to invest in small businesses that otherwise would not attract venture capital. Since Congress created the program in 1958, SBICs have been providing financing for more than 166,000 small businesses for a total of about $67 billion.[33]

venture capital money that is invested in small (and sometimes struggling) firms that have the potential to become successful

small-business investment companies (SBICs) privately owned firms that provide venture capital to small enterprises that meet their investment standards

5-7b **Debt Financing**

Small-business founders also use *debt financing*, which requires the entrepreneur to repay the invested amount at a later date. One of the most common sources of debt financing is business loans from banks or other financial institutions. However, banks are often reluctant to make loans to new businesses that do not have a credit history or other record of success, so entrepreneurs usually resort to other financial sources in the early stages. Credit cards are used extensively by small-business founders, but they represent only a small portion of total financing.

In addition to loans and credit cards, small businesses can also turn to short-term sources of debt, such as lines of credit from banks and trade credit from suppliers. These sources can help a firm expand to take advantage of new opportunities or stretch to get through hard times. Sometimes small-business owners barter their products to get what they need from other small businesses. There are even small-business bartering networks, such as BizX, through which members conduct transactions in BizX dollars that they earn by supplying goods and services. For example, Commonwealth Management, a California property management firm, let some tenants pay part of their rent in BizX dollars, which the firm then used to pay for janitorial and other services from businesses on the platform.[34]

5-7c **Crowdfunding**

A relatively new source of financing is *crowdfunding* through online sites such as Kickstarter and Indiegogo. In crowdfunding, entrepreneurs post descriptions of their project or business and then invite people to contribute. Contributors typically get a reward based on their contribution level; however, some crowdfunding sites work more like loans (debt financing) while others operate more like venture capitalists, with backers getting a small ownership share for their investment (equity financing). A sampling of projects on Kickstarter include fundraising campaigns by musical artists, filmmakers, app developers, and a variety of inventors. It is estimated that crowdfunding raised an annual $17.2 billion in the United States and is expected to grow to $300 billion globally by 2025.[35] Because business owners from underrepresented groups face greater financing challenges, they are increasingly turning to crowdfunding sources to grow their businesses. As an example, David Favela, who founded Border X Brewing, raised $200,000 in equity financing through crowdfunding sources.[36]

✓ Concept Check

- How can an entrepreneur finance a startup?
- What is the difference between debt and equity financing?

5-8 The Small Business Administration: Resources for Entrepreneurs

Learning Objective

5-8 Explain how the Small Business Administration helps small businesses.

The Small Business Administration helps people get into business and stay in business. The agency provides assistance to owners and managers of prospective, new, and established small businesses. Through more than 1,000 offices and resource centers throughout the nation, the SBA provides both financial assistance and management counseling. It helps small firms bid for and obtain government contracts, and it helps them prepare to enter foreign markets.

5-8a **SBA Management Assistance**

Statistics show that most failures in small business are related to poor management. Moreover, the owner is often the only manager, at least in a business's early years. For this reason, the SBA places special emphasis on improving the management ability of the owners and managers of small businesses. The SBA's extensive Management Assistance Program includes free individual counseling, courses, conferences, workshops, and a wide range of publications. The SBA also provides management and technical assistance to millions of small businesses through its 900 Small Business Development Centers and more than 10,000 volunteers from the SCORE Association. Additionally, the SBA's Emerging Leaders Initiative has trained more than 4,000 small-business owners in underserved communities since 2008.

Management Courses and Workshops The management courses offered by the SBA cover all the functions, duties, and roles of managers. Instructors may be teachers from local colleges and universities or other professionals, such as management consultants, bankers, lawyers, and accountants. Fees for these courses are quite low. One of the most popular courses is a general survey of eight to ten different areas of business management. Entrepreneurs can then follow up with courses that concentrate on one or more of these areas depending on their particular strengths and weaknesses. The SBA occasionally offers one-day conferences that are aimed at keeping owner-managers up-to-date on new management developments, tax laws, and the like. The SBA Learning Center is an online training platform consisting of 23 SBA-run courses, workshops, and resources. Some of the most requested courses include Entrepreneurship, Starting and Managing Your Own Business, Developing a Business Plan, Managing the Digital Enterprise, Identify Your Target Market, and Analyze Profitability.

SCORE **Service Corps of Retired Executives (SCORE)** is a group of more than 10,000 retired and active businesspeople, including veterans, women, and people of color, who volunteer their services to small-business owners through the SBA. Since 1964, SCORE has helped more than 11 million entrepreneurs through 250 offices with mentoring, webinars, workshops, and online resources. SCORE assigns mentors to work with small businesses based on their issues and challenges; business owners meet with their mentors in SCORE offices around the country or virtually via email or video. These services are free to business owners.[37] The collective experience of SCORE volunteers spans the full range of American enterprise. These volunteers have worked for such notable companies as Eastman Kodak, GE, IBM, and Procter & Gamble. Experts in areas of accounting, finance, marketing, engineering, and retailing provide counseling and mentoring to entrepreneurs.

Consider Jackie Mendive's Empanadas on the Go startup. Mendive learned to make empanadas from her mother in Argentina. After immigrating to the United States, friends loved her homemade empanadas, so she decided to go into business selling frozen empanadas that customers can heat up to eat at home. Mendive turned to SCORE to learn how to start a business. SCORE assigned Brian Jarvis to serve as her mentor, and he helped her with expert advice on the legal framework for her business, bookkeeping, branding, and marketing. Thanks to her mentor's advice and excellent word of mouth, her business is successful and growing after just one year.[38]

Small-Business Institutes **Small-business institutes (SBIs)**, created in 1972, are groups of senior and graduate students in business administration who provide management counseling to small businesses. SBIs have been set up on more than 520 college campuses as another way to help business owners. The students work in small groups guided by faculty advisers and SBA management-assistance experts. Like SCORE volunteers, they analyze and help solve the problems of small-business owners at their business establishments.

Small-Business Development Centers **Small-business development centers (SBDCs)** are university-based groups that provide individual counseling and practical training to owners of small businesses. SBDCs draw from the

Service Corps of Retired Executives (SCORE) a group of businesspeople who volunteer their services to small businesses through the SBA

small-business institutes (SBIs) groups of senior and graduate students in business administration who provide management counseling to small businesses

small-business development centers (SBDCs) university-based groups that provide individual counseling and practical training to owners of small businesses

The SBA provides a variety of services. When disaster strikes, the SBA makes relief available for stricken businesses.

U.S. Small Business Administration
SBA
DISASTER ASSISTANCE
Federal Disaster Loans for Homeowners, Renters and Businesses of All Sizes
FEMA / STATE
DISASTER RECOVERY CENTER

MICHELMOND/SHUTTERSTOCK.COM

resources of local, state, and federal governments, private businesses, and universities. These groups can provide managerial and technical help, data from research studies, and other types of specialized assistance of value to small businesses. There are nearly 1,000 SBDC locations, primarily at colleges and universities, assisting people such as Jen Barney, who happened to start her business just as the COVID-19 pandemic broke out. Although Barney is an expert baker—she won two Food Network Holiday Baking Championships—she knew little about the basics of starting a business. She turned to her local SBDC at the University of Wisconsin-LaCrosse, where counselor Terri Urbanek helped her with her business plan and marketing strategies and to make sense of key business data. Although Barney's Meringue Bakery & Café had a rocky first year because of the pandemic, she is now well-positioned to be successful in the future.[39]

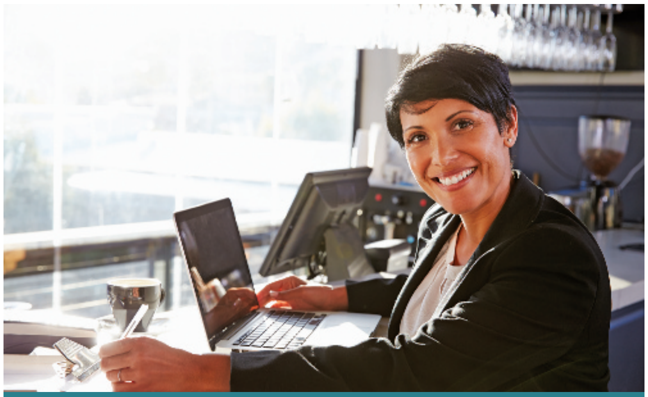
SBA Publications The SBA issues management, marketing, and technical publications dealing with hundreds of topics of interest to current and prospective managers of small firms. Most of these publications are available from the SBA free of charge. Others can be obtained for a small fee from the U.S. Government Printing Office.

5-8b SBA Financial Assistance

Small businesses seem to be constantly in need of money. An owner may have enough capital to start and operate the business. But then they require more money to finance increased operations during peak selling seasons, to pay for required pollution control equipment, to finance an expansion, or to mop up after a natural disaster such as a flood or a terrorist attack. The SBA distributed nearly $100 billion in Paycheck Protection Program loans to help small businesses keep employees on the payroll and stay open during the COVID-19 pandemic. The organization later forgave a significant percentage of the loans in order to help the economy during the crisis. The SBA has also guaranteed many billions of dollars more in loans to small businesses after disasters like Hurricanes Harvey and Laura. The SBA offers special financial-assistance programs that cover all these situations. However, its primary financial function is to guarantee loans to eligible businesses.

Regular Business Loans Most of the SBA's business loans are actually made by private lenders such as banks, but the agency partially guarantees repayment. That is, the SBA may guarantee that it will repay the lender up to 90 percent of the loan if the borrowing firm cannot repay it. Guaranteed loans approved may be as large as $5 million (this loan limit may be increased in the future). The average size of an SBA-guaranteed business loan is about $300,000, and its average duration is about eight years.

The Microloan program provides loans to help small businesses start and expand. Microloan can be used for working capital, inventory or supplies, furniture or fixtures, and machinery or equipment. The average microloan is about $13,000.


MONKEY BUSINESS IMAGES/SHUTTERSTOCK.COM

Helping businesses owned by underrepresented groups succeed. Are you ready to start your business, but don't know where to start or what opportunities are available to underrepresented groups? The SBA provides information on federal government programs and services that help people start their own businesses.

5-8c Help for Small Businesses Owned by Underrepresented Groups

Americans who are members of underrepresented groups have had difficulty entering the nation's economic mainstream and face additional hurdles when starting a new business. Raising money is a nagging problem for business owners who are women and/or people of color, who also may lack adequate training. Members of underrepresented groups are, of course, eligible for all SBA programs, but the SBA makes a special effort to assist those who want to start small businesses or expand existing ones. For example, the Minority Business Development Agency (MBDA) awards grants to develop and increase business opportunities for people of color. The agency also has offices devoted to supporting women, Native American, veteran, and LGBTQ-owned businesses with resources specific to each community. Additionally, SCORE maintains hubs for Latino and Black small-business owners with dedicated resources and mentors.

Helping women become entrepreneurs is also a special focus of the SBA. Entrepreneurs like Jessica Acosta, who founded Environmental Consulting Services in Colorado, have benefited from numerous SBA programs over the years. As a Latina, Acosta faced multiple hurdles in setting up her business, which helps clients deal with environmental management and water quality compliance. She turned to the Colorado Small Business Development Center Network for help, as well as the Mi Casa Women's Business Center, for consulting, training, classes, workshops, and networking that proved invaluable in helping her new business succeed. She now gives back to her community as a member of the Hispanic Chamber of Commerce.[40]

Now with more than 100 Women's Business Centers, entrepreneurs like Acosta can receive training and technical assistance and have access to credit and capital, federal contracts, and international markets. The SBA recently launched Ascent (https://ascent.sba.gov/), an online platform to help women gain the knowledge needed to operate a successful business. This free, interactive website offers women information about business principles and practices, management techniques, networking, industry news, market research and technology training, online counseling, and hundreds of links to other sites, as well as information about the many SBA services and resources available to them.

✓ Concept Check

- Identify ways in which the SBA provides management assistance to small businesses.
- Identify ways in which the SBA provides financial assistance to small businesses.
- Why does the SBA concentrate on providing management and financial assistance to small businesses?

5-9 Global Perspectives in Small Business

Learning Objective

5-9 Explore how small businesses can take advantage of global markets.

For small U.S. businesses, the world is becoming smaller. As we saw in Chapter 3, increasingly interdependent national economies and dwindling trade barriers are creating opportunities for businesses large and small to find customers all over the world. Globalization and real-time worldwide communications are rapidly shrinking distances at the same time that they are expanding business opportunities. The internet and online payment systems enable even very small businesses to serve international customers. In fact, technology now gives small businesses the leverage and power to reach markets that were once limited solely to large corporations. Moreover, small businesses that engage in international business tend to grow faster and are more likely to remain in business. However, despite the fact that more than 75 percent of the world's purchasing power is outside of the United States, only about 1 percent of small businesses in the United States currently engage in deliberate exporting.[41]

To boost small-business participation in global markets, the SBA offers several programs that can help small-business owners who want to expand into world markets. The SBA's efforts include counseling small firms on how and where to market overseas, matching U.S. small-business executives with potential overseas customers, and helping exporters to secure financing. The agency brings small U.S. firms into direct contact with potential overseas buyers and partners. The SBA International Trade Loan program provides guarantees of up to $5 million in loans to small-business owners. These loans help small firms in expanding or developing new export markets. U.S. Export Assistance Centers, staffed by experts from the SBA, Department of Commerce, Export-Import Bank, and other public and private organizations are located in major U.S. metropolitan areas. The State Trade Expansion Program (STEP) helps companies find overseas customers and obtain grants through states and U.S. territories. Consider My Med Choices, Inc., a Delaware firm that provides travel services for medical treatment. The company secured STEP funds to join a Delaware-state-led business trip to South Korea, Thailand, and Australia. That trip led to agreements and contracts with one of the largest hospitals in the world and Australia's largest hospital system. Thanks to opportunities from STEP, the company expects to grow to $40 million.[42]

International trade will become more important to small-business owners as they face unique challenges in the new century. Small businesses, which are expected to remain the dominant form of organization in this country, must be prepared to adapt to significant demographic and economic changes in the world marketplace.

This chapter ends our discussion of American business today. From here on, we shall be looking closely at various aspects of business operations. We begin, in the next chapter, with a discussion of management—what management is, what managers do, and how they work to coordinate the basic economic resources within a business organization.

✓ Concept Check

- How does the SBA help small-business owners who want to enter the world markets?
- What are the global perspectives in small business?

Summary

5-1 Recognize the importance of small businesses to the U.S. economy.

A small business is an independent business with fewer than 500 employees, depending on its industry. This definition comes from the Small Business Administration (SBA), which was created in 1953 to assist, counsel, and protect the interests of small businesses in the United States. There are about 31.7 million businesses in this country, and 99.9 percent of them are small businesses. Small businesses are vital to the U.S. economy, providing technical innovation, employment, and competition, and satisfying the needs of society. Entrepreneurs often choose to start businesses in distribution, service, or production.

5-2 Describe the kinds of people who start small businesses.

The entrepreneurial spirit may stem from many reasons. Such personal characteristics as independence, desire to create a new enterprise, and willingness to accept a challenge may encourage individuals to start small businesses. Various external circumstances, such as special expertise or even the loss of a job, also can supply the motivation to strike out on one's own. Women, teenagers, and immigrants are starting small businesses in record numbers.

5-3 Describe the advantages and disadvantages of operating a small business.

The advantages of smallness in business include the opportunity to establish personal relationships with customers and employees, the ability to adapt to changes quickly, independence, and simplified record keeping. The major disadvantages are the high risk of failure, the limited potential for growth, and the limited ability to raise capital.

5-4 Examine some common reasons for business failure.

Poor planning and lack of capital and management experience are the major causes of small-business failures.

5-5 Discuss the importance of a business plan.

A business plan is a carefully constructed guide for the person starting a business. It is a tool with three basic purposes: communication, management, and planning. It should answer the four basic questions: (1) What exactly is the nature and mission of the new venture? (2) Why is this new enterprise a good idea? (3) What are the businessperson's goals? (4) How much will the new venture cost?

5-6 Explore franchising, including its types, growth, and advantages and disadvantages.

A franchise is a license to operate an individually owned business as though it were part of a chain. The franchisor provides a known business name, management skills, a method of doing business, and the training and required materials. The franchisee contributes labor and capital, operates the franchised business, and agrees to abide by the provisions of the franchise agreement. Franchising has grown tremendously since the mid-1970s. There are three major categories of franchise agreements. The franchisor's major advantage in franchising is fast and well-controlled distribution of products with minimal capital outlay. In return, the franchisee has the opportunity to open a business with limited capital, to make use of the business experience of others, and to sell to an existing clientele. For this, the franchisee usually must pay both an initial franchise fee and a continuing royalty based on sales. Franchisees also must follow the dictates of the franchise with regard to operation of the business.

5-7 Describe methods entrepreneurs can use to finance their small business.

Most small-business owners finance their startups by using their own personal savings, borrowing from family and friends, and using personal credit cards. Equity financing involves raising funds by promising investors a share of future profits and an ownership stake in the business. Venture capital is money that is invested in small (and sometimes struggling) firms that have the potential to become successful. Debt financing requires the business owner to repay the invested amount at a later date. Increasingly, entrepreneurs use crowdfunding to secure debt or equity financing.

5-8 Explain how the Small Business Administration helps small businesses.

The Small Business Administration (SBA) offers management courses and workshops; managerial help, including one-to-one counseling through SCORE; various publications; and financial assistance through guaranteed loans and SBICs. It places special emphasis on aid to small businesses owned by women and underrepresented groups.

5-9 Explore how small businesses can take advantage of global markets.

Worldwide business opportunities are expanding for small businesses. The SBA assists small-business owners in penetrating foreign markets. The next century will present unique challenges and opportunities for small-business owners.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

Small Business Administration (SBA) (132)
small business (132)
business plan (144)
franchise (145)
franchising (145)
franchisor (145)
franchisee (145)
venture capital (151)
small-business investment companies (SBICs) (151)
Service Corps of Retired Executives (SCORE) (153)
small-business institutes (SBIs) (153)
small-business development centers (SBDCs) (153)

Discussion Questions

1. What industries seem to be most attractive to entrepreneurs? Why do you think that is?
2. How do entrepreneurs differ from other people? What kinds of things motivate them?
3. What benefits do small businesses provide our economy? Given all these benefits, should society do more to protect them?
4. What are the most common reasons that small businesses fail? What steps should entrepreneurs take to protect their firms from failure?
5. Are the so-called advantages of small business really advantages? Wouldn't every small-business owner like their business to grow into a large firm?
6. What is the role of the business plan?
7. Do average citizens benefit from the activities of the SBA, or is the SBA just another way to spend our tax money?
8. Would you rather own your own business independently or become a franchisee? Why?
9. Why should small businesses engage in exporting?

Case 5

Traits of the Most Successful Entrepreneurs

When one hears the word entrepreneur, many faces come to mind. Elon Musk, Sara Blakely, Warren Buffet, Martha Stewart, Bill Gates, and Daymond John are just a few that might spring to mind. There are a variety of traits that characterize entrepreneurs such as having an entrepreneurial spirit, being independent, and embracing failure. An entrepreneurial spirit is a mindset that embraces innovation and continuous improvement. Being an entrepreneur also requires the desire to work hard, take risks, and pursue one's passions.

Entrepreneurs have the ability to identify gaps in the market. That was the case with entrepreneur Vera Wang. Wang started working for *Vogue* magazine at the age of 22 and became the fashion editor by 23. Later, she was the design director for Ralph Lauren, a luxury American fashion company. With extensive experience in the fashion industry, she recognized an opportunity to introduce sophisticated, dramatic, feminine, and modern bridal gown designs. She opened her own boutique which quickly became popular, attracting celebrity clients such as Kate Hudson and Victoria Beckham. Wang, who continues to design iconic wedding dresses, has a net worth of $650 million.

Entrepreneurs think creatively and bring new perspectives to the table. This can be seen with Google's co-founders Sergey Brin and Larry Page. The two worked on a research project at Stanford University called BackRub. They created a search tool that ranked websites based on the number of backlinks they had (i.e., links to websites from other websites). At the time, existing search engines ranked websites based on how many times a search term appeared on the page. This advanced algorithm led to Google. Within its first five years, Google had more than 18 million searches a day.

Successful entrepreneurs have a desire to pursue their passions. Mark Zuckerberg, for example, developed a love for programming at an early age. When he was 12, he created a messaging platform he called Zucknet for inter-office communication at his dad's business. Microsoft even tried to recruit Zuckerberg as a result of his Synapse music player, but he declined so he could attend college. While in college, Zuckerberg developed several programs including CourseMatch, FaceMash, and Facebook. Facebook now has nearly 3 billion users.

Entrepreneurs have to be willing to work hard. Mark Cuban, an American entrepreneur, television personality, and the owner of the NBA's Dallas Mavericks, has an estimated worth of $4.3 billion. Cuban showed a willingness to work hard from a young age, selling garbage bags at the age of 12 so that he could afford basketball shoes. After college, Cuban founded MicroSolutions, which he later sold for $6 million. Cuban says he worked 20-hour-days and didn't take a vacation for seven years. Not long after, Cuban co-founded Broadcast.com, an online streaming audio service that was acquired by Yahoo for $5.7 billion in stock.

Entrepreneurs are risk-takers. Bill Gates, the founder of Microsoft, took a big risk when he was a student at Harvard University. When the world's first personal computer kit, the Altair, was created, Gates and his friend Paul Allen contacted the manufacturer about having written a computer language for the microcomputer. In reality, they were far from ready. When the president of the company returned Gates' phone call, he and Allen worked day and night to convert BASIC, a popular mainframe computer programming language, for use on the personal computer.

There are millions of entrepreneurs in the United States alone, but having an entrepreneurial spirit is not enough to guarantee success. Unfortunately, there is no perfect formula. But having the right mindset and traits can go a long way. Do you think you have what it takes?[43]

Questions

1. Describe what it means to have an entrepreneurial spirit. Use one of the entrepreneurs mentioned as an example.
2. Why is it important to be able to identify gaps in the market?
3. Aside from the traits discussed here, what other personal factors do you think contribute to entrepreneurial success?

Building Skills for Career Success

1. Social Media Exercise

American Express's "Business Class" is a website that is designed for small-business owners (https://www.americanexpress.com/en-us/business/trends-and-insights/). Take a look at the Business Class website and answer the following questions:

a. What questions can Business Class answer for business owners?
b. Develop a list of five issues or topics that you feel illustrate how American Express does an effective job of presenting information on this website.

2. Building Team Skills

A business plan is a written statement that documents the nature of a business and how that business intends to achieve its goals. Although entrepreneurs should prepare a business plan *before* starting a business, the plan also serves as an effective guide later on. The plan should concisely describe the business's mission, the amount of capital it requires, its target market, competition, resources, production plan, marketing plan, organizational plan, assessment of risk, and financial plan.

Assignment

1. Working in a team of four students, identify a company in your community that would benefit from using a business plan, or create a scenario in which a hypothetical entrepreneur wants to start a business.
2. Using the resources of the library or the internet and/or interviews with business owners, write a business plan incorporating the information in Table 5-3.
3. Present your business plan to the class.

3. Researching Different Careers

Many people dream of opening and operating their own businesses. Are you one of them? To be successful, entrepreneurs must have certain characteristics; their profiles generally differ from those of people who work for someone else. Do you know which personal characteristics make some entrepreneurs succeed and others fail? Do you fit the successful entrepreneur's profile? What is your potential for opening and operating a successful small business?

Assignment

1. Use the resources of the library or the internet to establish what a successful entrepreneur's profile is and to determine whether your personal characteristics fit that profile. You may be able to find some quizzes online (try https://smallbiztrends.com/2019/10/entrepreneur-quiz.html or https://www.bbc.com/news/business-33851439) that can help you to assess your personal characteristics. The SBA also has helpful brochures.
2. Interview several small-business owners. Ask them to describe the characteristics they think are necessary for being a successful entrepreneur.
3. Using your findings, write a report that includes the following:
   a. A profile of a successful small-business owner;
   b. A comparison of your personal characteristics with the profile of the successful entrepreneur; and
   c. A discussion of your potential as a successful small-business owner.

Running a Business

Part 2

Graeter's: A Fourth-Generation Family Business

Independent and family-owned for more than 150 years, Graeter's has successfully made the transition from a 19th-century mom-and-pop ice cream business to a 21st-century corporation with three manufacturing facilities, 55 ice cream shops, and hundreds of employees. Much of the company's success over the years has been due to the family's strong and enduring entrepreneurial spirit.

Small Business, Big Ambitions

The road to small-business success started with co-founder Louis Charles Graeter, who developed the startup's first flavors, insisted on only the finest ingredients, and made all his ice cream by hand in small batches to ensure freshness and quality. After his death, his wife and co-founder Regina maintained the same high level of quality as she led the company through three decades of aggressive growth. Her great-grandson, CEO Richard Graeter II, says that "without her strength, fortitude, and foresight, there would be no Graeter's ice cream today."

Richard, Bob, and Chip, great-grandsons of the founders, are the fourth generation to own and operate Graeter's. They grew up in the business, and now they share responsibility for the firm's day-to-day management and for determining its future direction. Bob worked his way up to vice president of operations, starting with a management position in one of the Graeter's ice-cream shops. Chip, currently vice president of retail operations, handled all kinds of jobs in Graeter's stores as a teenager. He uses this first-hand knowledge of customer relations to finetune every store function.

Richard Graeter became the company's CEO in 2007. "Even though I have the title of CEO, in a family business titles don't mean a whole lot," he comments. "The functions that I am doing now as CEO, I was doing as executive vice president for years . . . It really was and remains a partnership with my two cousins . . . Our fathers brought us into the business at an early age . . . I think most important is we saw our fathers and their dedication and the fact that, you know, they came home later, they came home tired, they got up early and went to work before we ever got up to go to school in the morning, and you see that dedication and appreciate that—that is what keeps your business going."

Graeter continues, "It can be challenging to work with your family. My father and I didn't always see things the same way. But on the other hand, there is a lot of strength in the family relationship . . . we certainly had struggles, and family businesses do struggle, especially with transition . . . but we found people to help us, including lawyers, accountants, and a family-business psychologist."

Growing Beyond Cincinnati

To expand beyond Cincinnati without diverting resources from the existing stores and factory, the third generation of Graeter's family owners decided to license a handful of franchise operators. One franchise operation was so successful that it even opened its own factory. A few years ago, however, the fourth generation switched gears on growth and repurchased all the stores of its last remaining franchisee. "When you think about Graeter's," says the CEO, "the core of Graeter's is the quality of the product. You can't franchise your core. So by franchising our manufacturing, that created substantial risk for the organization because the customer doesn't know that it is a franchise. . . . They know it is Graeter's. . . . You really have to rely on the intention and goodwill of the individual franchisees to make the product the way you would make it, and that is not an easy thing to guarantee."

After working with consultants to carefully analyze the situation and evaluate alternative paths to future growth, the founder's great-grandsons decided against further franchising. Instead, they pursued nationwide distribution through a large network of grocery stores and supermarket chains. They also built a new facility to increase production capacity and hired experienced executives to help manage the expanded business.

As a private company, Graeter's can take actions like these without worrying about the reaction of the stock market. Specifically, Graeter's is an S corporation, which allows it limited-liability protection coupled with the benefit of not being taxed as a corporation. Instead, the three owners—who are the stockholders—pay only personal income taxes on the corporation's profits. In the event of significant legal or tax code changes, Graeter's owners do have the option of choosing a different form of corporate organization.[44]

Questions

1. Graeter's current management team bought the business from their parents, who did not have a formal

succession plan in place to indicate who would do what. Do you think the current team should have such a plan specifying who is to step into the business, when, and with what responsibilities? Why or why not?

2. Graeter's hired management consultants to help improve its training procedures and expand distribution. "I think my cousins and I all have come to realize we can't do it alone," says the CEO. Why do you think the management team made this decision? Does the involvement of outside consultants move Graeter's further from its roots as a family business?
3. Do you agree with Graeter's decision to stop franchising? Explain your answer.

Building a Business Plan

Part 2

After reading Part 2, "Business Ownership and Entrepreneurship," you should be ready to tackle the company and industry component of your business plan. In this section, you will provide information about the background of the company, choice of the legal business form, information on the product or services to be offered, and descriptions of potential customers, current competitors, and the business's future. This chapter and the previous chapter in your textbook—Chapter 4, "Choosing a Form of Business Ownership," and Chapter 5, "Small Business, Entrepreneurship, and Franchises"—can help you to answer some of the questions in this part of the business plan.

The Company and Industry Component

The company and industry analysis should include the answers to at least the following questions:

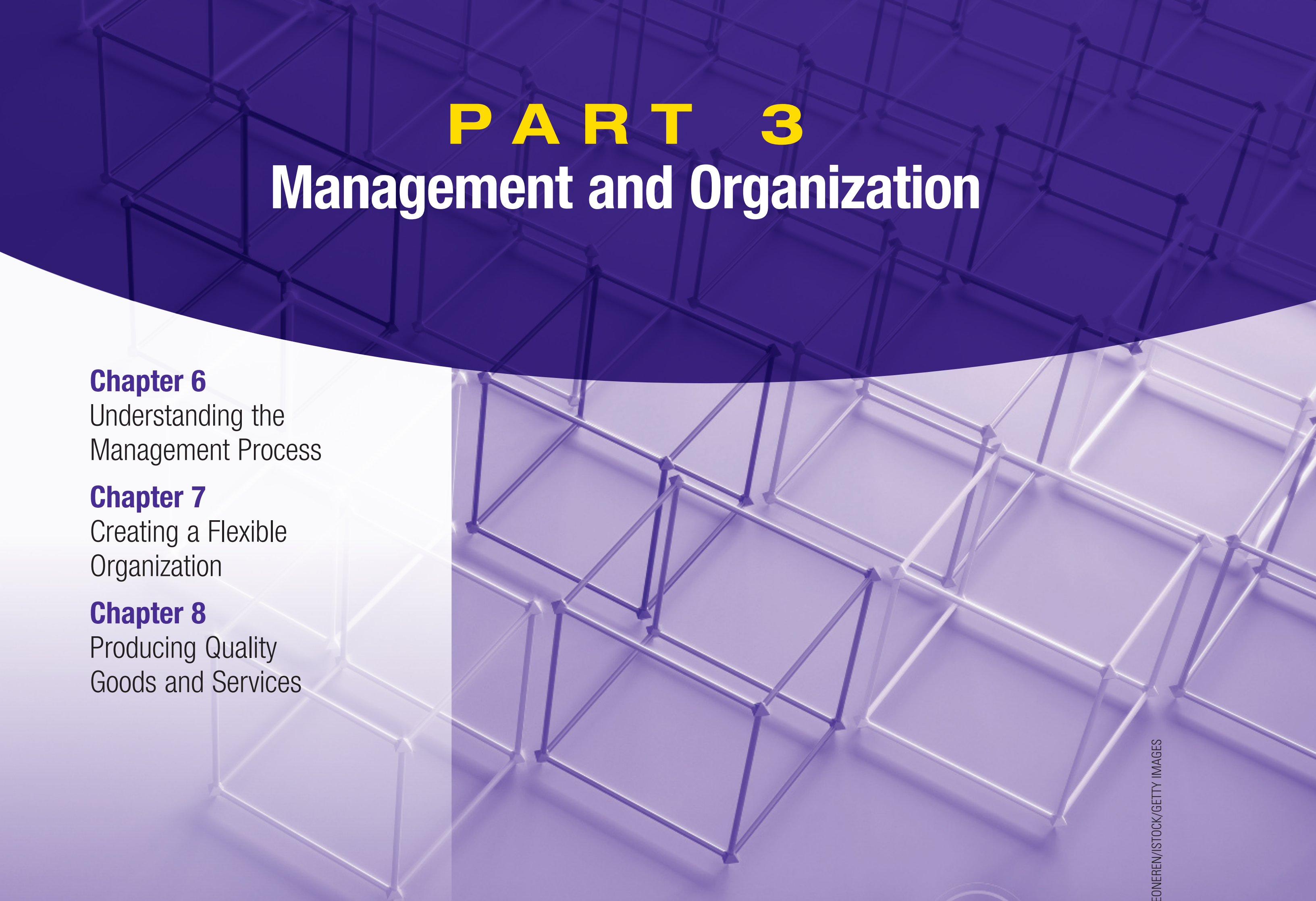
2.1. What is the legal form of your business? Is your business a sole proprietorship, a partnership, or a corporation?
2.2. What licenses or permits will you need, if any?
2.3. Is your business a new independent business, a takeover, an expansion, or a franchise?
2.4. If you are dealing with an existing business, how did your company get to the point where it is today?
2.5. What does your business do, and how does it satisfy customers' needs?
2.6. How did you choose and develop the products or services to be sold, and how are they different from those currently on the market?
2.7. What industry do you operate in, and what are the industry-wide trends?
2.8. Who are the major competitors in your industry?
2.9. Have any businesses recently entered or exited? Why did they leave?
2.10. Why will your business be profitable, and what are your growth opportunities?
2.11. Does any part of your business involve e-business?

Review of Business Plan Activities

Make sure to check the information you have collected, make any changes, and correct any weaknesses before beginning Part 3. *Reminder:* Review the answers to questions in the preceding part to make sure that all your answers are consistent throughout the business plan. Finally, write a summary statement that incorporates all the information for this part of the business plan.

PART 3

Management and Organization


EONEREN/ISTOCK/GETTY IMAGES

Chapter 6
Understanding the Management Process

Chapter 7
Creating a Flexible Organization

Chapter 8
Producing Quality Goods and Services

IPOPBA/ISTOCK/GETTY IMAGES

This part of the book deals with the organization—the “thing” that is a business. We begin with a discussion of the management functions involved in developing and operating a business. Next, we analyze the organization’s elements and structure. Then we consider a firm’s operations that are related to the production of goods and services.

Chapter

6

ISTOCK.COM/JOVANMANDIC

Understanding the Management Process

Learning Objectives

Once you complete this chapter, you will be able to:

6-1 Define management.

6-2 Describe the four basic management functions: planning, organizing, leading and motivating, and controlling.

6-3 Distinguish among the various kinds of managers in terms of both level and area of management.

6-4 Recognize the key management skills of successful managers.

6-5 Identify the different types of leadership.

6-6 Discuss the steps in the managerial decision-making process.

Why Should You Care?

Most of the people who read this chapter will advance upward and become managers. Thus, an overview of the field of management is essential.

Inside Business

Hands-On Investors Question Twitter's Hands-Off Management

Jack Dorsey, a technology entrepreneur, is the co-founder and CEO of Twitter, a social networking service, as well as the founder and CEO of Square, a mobile payment company. Dorsey is known for being a hands-off leader. According to current and former employees, Dorsey is slow to act and tends to delegate major decisions. Investors, unsure if Dorsey could dedicate enough time to Twitter due to his split responsibilities and arms-length leadership style, launched an evaluation of the company's management performance.

Elliott Management Corp., which took a sizeable stake in Twitter, has a reputation as one of Wall Street's toughest activist investors. Elliott Management raised questions about Dorsey's management abilities after Dorsey decided to work remotely from Africa while still leading both of his companies. To appease investors, Twitter appointed two new board members, committed to $2 billion in share buybacks, and formed a committee to study Twitter's leadership. After months of evaluation, the board committee recommended that Twitter's management structure remain in place but suggested changes to the board structure to allow investors to have more authority.

Though the initial investigation is complete, the board committee will continue to evaluate Twitter's management performance ongoing. When Dorsey was questioned about his time management at an annual shareholder's meeting, he said, "To me, this is not a function of time, it's a function of prioritization." Dorsey maintains that he is able to focus on the most important challenges his companies face.[1]

Did You Know?

Jack Dorsey is the only person to be the CEO of two public companies with market valuations greater than $5 billion.

The leadership burdens that confront Jack Dorsey as the chief executive of Twitter illustrate that management can be one of the most challenging yet rewarding professions available today. Depending on its size, a firm may employ a number of specialized managers who are responsible for particular areas of management, such as marketing, finance, and operations. That same organization also includes managers at several levels within the firm.

In this chapter, we define *management* and describe the four basic management functions of planning, organizing, leading and motivating, and controlling. Then we focus on the types of managers with respect to levels of responsibility and areas of expertise. Next, we focus on the skills of effective managers and the different roles managers must play. Finally, we examine several styles of leadership and explore the process by which managers make decisions.

6-1 What Is Management?

Learning Objective

6-1 Define management.

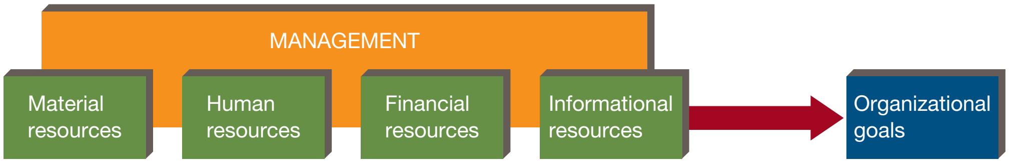
Management is the process of coordinating people and other resources to achieve the goals of an organization. As we saw in Chapter 1, most organizations make use of four kinds of resources: material, human, financial, and informational (refer to Figure 6-1).

management the process of coordinating people and other resources to achieve the goals of an organization

Material resources are the tangible, physical resources an organization uses. For example, General Motors uses steel, glass, and fiberglass to produce cars and trucks on complex machine-driven assembly lines. A college or university uses books, classroom buildings, desks, and computers to educate students. However, the Mayo Clinic uses operating room equipment, diagnostic machines, and laboratory tests to provide healthcare.

Figure 6-1 The Four Main Resources of Management

Managers coordinate an organization's resources to achieve the organization's goals.



Perhaps the most important resources of any organization are its *human resources*—people. In fact, some firms live by the philosophy that employees are their most important assets. Some managers believe that the way employees are developed and managed has more impact on an organization than other vital components such as marketing, financial decisions, production, or technology. Research supports this belief. It shows that prioritizing human resources and working to ensure that employees are happy can greatly affect productivity and customer relationships.

Financial resources are the funds an organization uses to meet its obligations to investors and creditors. A 7-Eleven convenience store obtains money from customers at the checkout counter and uses a portion to pay its employees and suppliers. Your college obtains money in the form of tuition, income from endowments, and state and federal grants. It uses the money to pay bills, insurance premiums, and salaries.

Increasingly, organizations are finding that they cannot afford to ignore *information*. External environmental conditions—the economy, consumer markets, technology, politics, and cultural forces—are all changing so rapidly that a business must adapt to survive. To adapt to change, the business must gather information about competitors and changes to the industry in order to learn from the failures and successes of others.

It is important to realize that the four types of resources described earlier are only general categories. Within each category are hundreds or thousands of more specific resources. It is this complex mix of specific resources—which varies between companies and industries—that managers must coordinate to produce goods and services.

Another way to look at management is in terms of the different functions managers perform, which are planning, organizing, leading and motivating employees, and controlling. We look at each of these management functions in the next section.

✓ Concept Check

- What is management?
- What are the four kinds of resources?

6-2 Basic Management Functions

Learning Objective

6-2 Describe the four basic management functions: planning, organizing, leading and motivating, and controlling.

Management functions do not occur according to some rigid, preset timetable. Managers do not plan in January, organize in February, lead and motivate in March, and control in April. At any given time, managers may engage in a number of functions simultaneously. However, each function tends to lead naturally to others. Figure 6-2 provides a visual framework for a more detailed discussion of the four basic management functions. How well managers perform these key functions determines whether a business is successful.

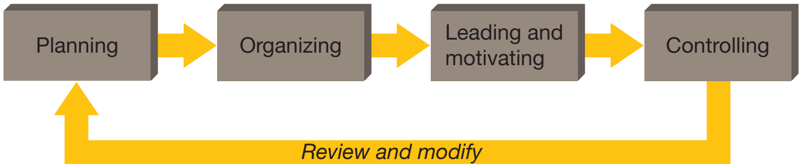
6-2a Planning

Planning, in its simplest form, is establishing organizational goals and deciding how to accomplish them. It is often referred to as the "first" management function because all other management functions depend on planning.

planning establishing organizational goals and deciding how to accomplish them

Figure 6-2 **The Management Process**

Note that management is not a step-by-step procedure but a process with a feedback loop that represents a flow.



Organizations such as Starbucks, Amazon, and Nike base the planning process on a mission statement. An organization's **mission** is a statement of the basic purpose that makes that organization different from others. Starbucks' mission statement, for example, is "to inspire and nurture the human spirit—one person, one cup, and one neighborhood at a time."[2] Amazon's mission is "to be Earth's most customer-centric company."[3] Nike's mission is "to bring inspiration and innovation to every athlete in the world."[4] Once an organization has decided on its mission, the next step is strategic planning.

mission a statement of the basic purpose that makes an organization different from others

strategic planning process the establishment of an organization's major goals and objectives and the allocation of resources to achieve them

goal an end result that an organization is expected to achieve over a one- to ten-year period

objective a specific statement detailing what an organization intends to accomplish over a shorter period of time

Strategic Planning Process The **strategic planning process** involves establishing an organization's major goals and objectives and allocating resources to achieve them. Top management is responsible for strategic planning, although customers, products, competitors, and company resources all factor into the process.

In today's rapidly changing business environment, constant internal or external changes may necessitate changes in a company's goals, mission, or strategy. Consider that many firms had to shelve plans to open new stores and instead close or modify operations at existing ones in response to the COVID-19 pandemic. The timeline for strategic plans is generally one to two years, but can be much longer. Strategic plans should be flexible and include action items, such as outlining how plans will be implemented.

Establishing Goals and Objectives A **goal** is an end result that an organization is expected to achieve over a one- to ten-year period. An **objective** is a specific

Human resources. Superior human resources management can set a firm apart. Do you have a great business plan or product? A competitor can easily copy both. Great employees, however, are much harder to duplicate. That's why being able to attract, train, and retain talented workers can give a firm a competitive advantage over its rivals.

ISTOCK.COM/JCECILIE_ARCURS

statement detailing what the organization intends to accomplish over a shorter period of time.

Goals and objectives can involve a variety of factors, such as sales, company growth, costs, customer satisfaction, and employee morale. Although a small manufacturer may focus primarily on sales objectives for the next six months, a large firm may be more interested in goals that will drive the firm for several years. Verizon, for example, launched a "responsible business plan" called Citizen Verizon, which included a goal to become fully carbon neutral by 2035 by reducing emissions, implementing more renewable energy, and purchasing carbon offsets.[5] Finally, goals are set at every level of an organization. Every member of an organization—the president of the company, the head of a department, and an operating employee at the lowest level—has a set of goals that they hope to achieve.

It is likely that some conflicts will arise among levels within the organization, but goals must be made consistent across an organization. A production department, for example, may have a goal of minimizing costs. One way to do this is to produce only one type of product. Marketing may have a goal of maximizing sales, which might be achieved by offering a wide range of products and options. As part of goal-setting, the manager responsible for *both* departments must strike a balance between conflicting goals. This balancing process is called *optimization*.

The optimization of conflicting goals requires insight and ability. Faced with the marketing-versus-production conflict just described, most managers would find a middle ground through offering a moderately diverse product line featuring only the most popular products. Such a compromise would be best for the whole organization.

SWOT Analysis **SWOT analysis** is the identification and evaluation of a firm's strengths, weaknesses, opportunities, and threats. Strengths and weaknesses are internal factors that affect a company's capabilities. Strengths refer to a firm's favorable characteristics and core competencies. **Core competencies** are approaches and processes that a company performs well that may give it an advantage over its competitors. These core competencies may help the firm attract financial and human resources that increase the firm's capacity to produce products that satisfy customers. Weaknesses refer to internal limitations a company faces in developing or implementing plans. At times, managers have difficulty identifying and understanding the negative effects of weaknesses in their organizations.

External opportunities and threats exist independently of the firm. Opportunities refer to favorable conditions in the environment that could benefit the organization if properly exploited. Threats, on the other hand, are conditions or barriers that may prevent the firm from reaching its objectives. Opportunities and threats can stem from many sources within the business environment. Because environmental factors vary between firms and industries, threats for some firms may be opportunities for others. Examples of strengths, weaknesses, opportunities, and threats are shown in Figure 6-3.

Types of Plans Once goals and objectives have been set for the organization, managers must develop plans for achieving them. A **plan** is an outline of the actions by which an organization intends to accomplish its goals and objectives. The organization develops several types of plans, as shown in Figure 6-4.

An organization's **strategic plan** is its broadest plan, developed as a guide during the strategic planning process for major policy setting and decision making. Strategic plans are set by the board of directors and top management and are generally designed to achieve the organization's long-term goals. Thus, a firm's strategic plan defines what business the company is in or wants to be in and the kind of company it is or wants to be. For example, Tesla, headed by Elon Musk, crafted a strategic plan to first develop and introduce a viable electric performance car and then to follow with a well-made model for the luxury car market.

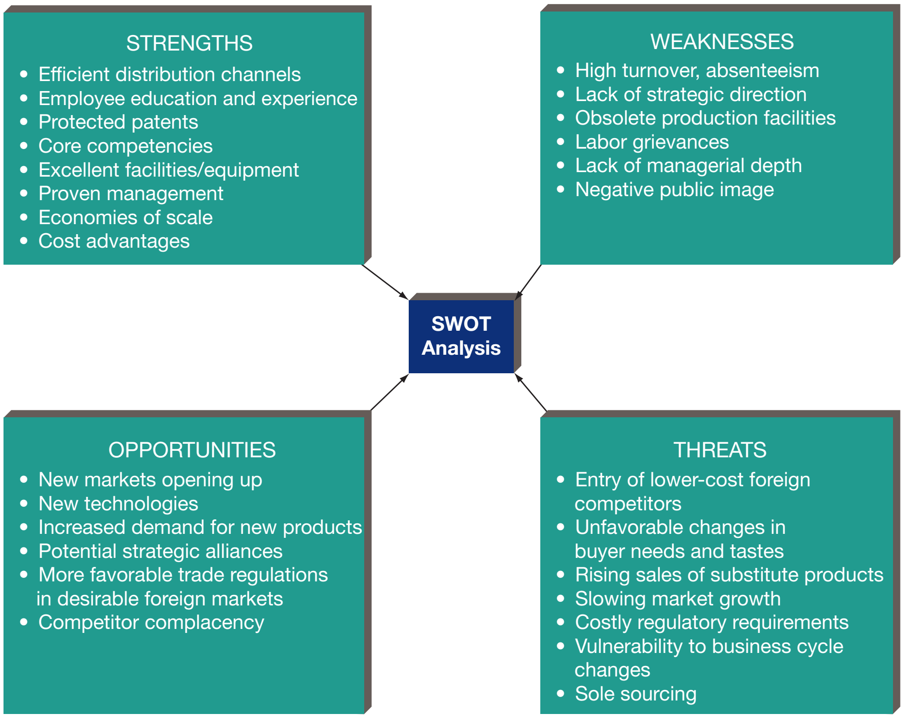
SWOT analysis the identification and evaluation of a firm's strengths, weaknesses, opportunities, and threats

core competencies approaches and processes that a company performs well that may give it an advantage over its competitors

plan an outline of the actions by which an organization intends to accomplish its goals and objectives

strategic plan an organization's broadest plan, developed as a guide for major policy setting and decision making

Figure 6-3 Elements and Examples of SWOT Analysis


STRENGTHS
• Efficient distribution channels
• Employee education and experience
• Protected patents
• Core competencies
• Excellent facilities/equipment
• Proven management
• Economies of scale
• Cost advantages
WEAKNESSES
• High turnover, absenteeism
• Lack of strategic direction
• Obsolete production facilities
• Labor grievances
• Lack of managerial depth
• Negative public image
SWOT Analysis
OPPORTUNITIES
• New markets opening up
• New technologies
• Increased demand for new products
• Potential strategic alliances
• More favorable trade regulations in desirable foreign markets
• Competitor complacency
THREATS
• Entry of lower-cost foreign competitors
• Unfavorable changes in buyer needs and tastes
• Rising sales of substitute products
• Slowing market growth
• Costly regulatory requirements
• Vulnerability to business cycle changes
• Sole sourcing

The company's first venture, the Tesla Roadster, fulfilled the first part of the plan, and its well-received Model S satisfied the second. These successes enabled Tesla to generate funds and brand recognition to launch the final part of its strategic plan to introduce a mass-market $35,000 electric vehicle, the Model 3, which had a lengthy waiting list to purchase years in advance of its introduction. Customer satisfaction with and enthusiasm for these vehicles along with Musk's charisma and showmanship fueled demand for even more electric vehicle types—including the Cybertruck pickup and a semi. Tesla is now executing a new strategic plan that involves using Tesla-branded batteries and solar technology to power not only electric cars but households, cities, and more with new products such as autonomous vehicles.[6]

In addition to strategic plans, most organizations also employ several narrower kinds of plans. A **tactical plan** is a smaller-scale plan developed to implement a strategy. Most tactical plans cover a one- to three-year period. If a strategic plan will take five years to complete, the firm may develop five tactical plans, one covering each year. Tactical plans may be updated periodically as dictated by conditions and experience. Their more limited scope permits them to be changed more easily than strategies. For example, as part of its strategic plan to slash costs, AT&T's COO John Stankey launched several tactical plans to restructure some aspects of the telecommunications conglomerate, streamline operations, lay off employees, and improve energy efficiency. Stankey expects these one- to three-year plans to yield millions of dollars in savings and help the firm achieve its profit margin goals.[7]

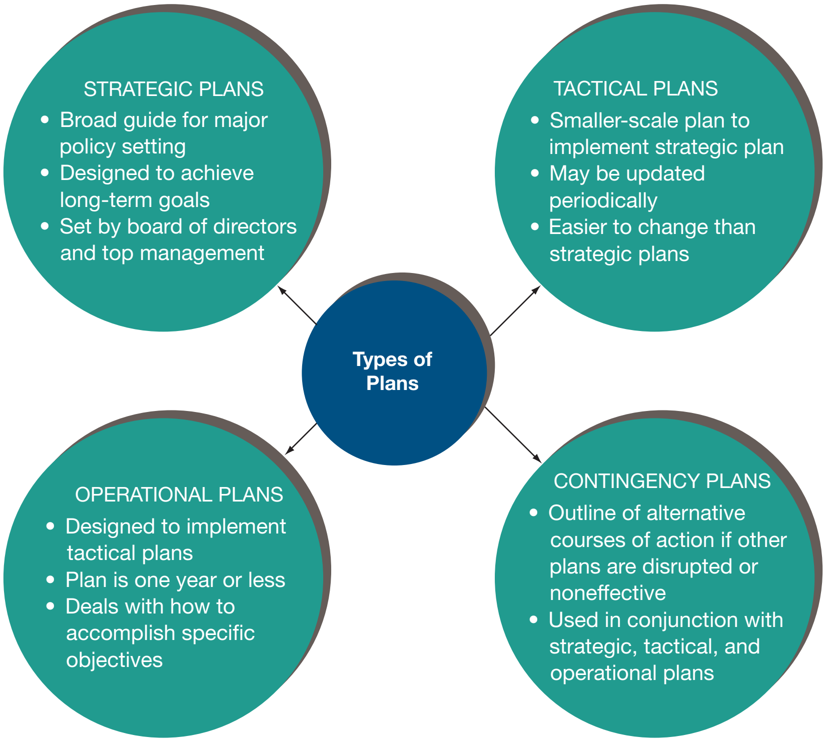
An **operational plan** is a type of plan designed to implement tactical plans. Operational plans are usually established for one year or less and deal with how to accomplish the organization's specific objectives.

tactical plan a smaller-scale plan developed to implement a strategy

operational plan a type of plan designed to implement tactical plans

Figure 6-4 Types of Plans

Managers develop and rely on several types of plans.


Types of Plans
STRATEGIC PLANS
• Broad guide for major policy setting
• Designed to achieve long-term goals
• Set by board of directors and top management
TACTICAL PLANS
• Smaller-scale plan to implement strategic plan
• May be updated periodically
• Easier to change than strategic plans
OPERATIONAL PLANS
• Designed to implement tactical plans
• Plan is one year or less
• Deals with how to accomplish specific objectives
CONTINGENCY PLANS
• Outline of alternative courses of action if other plans are disrupted or noneffective
• Used in conjunction with strategic, tactical, and operational plans

Regardless of how hard managers try, sometimes business activities do not go as planned. Today, most corporations also develop contingency plans along with strategies, tactical plans, and operational plans. A **contingency plan** is a plan that outlines alternative courses of action that may be taken if an organization's other plans are disrupted or become ineffective. Contingency plans may address disruptions caused by natural disasters, pandemics, criminal or ethical misconduct, hacking, political instability, or other unexpected activities. Also known as crisis plans, contingency plans can help halt the escalation of a disruptive situation and thereby minimize further harm to people, resources, or reputations. H-E-B, a Texas-based supermarket chain, has crisis plans and emergency management teams to help weather hurricanes and other disasters so that it can continue to serve its customers and support its employees. These initiatives also helped the company keep its supply chains moving during the COVID-19 pandemic.[8] Despite their usefulness, about one third of companies lack a crisis plan, and those that do have contingency plans often fail to update or practice for them, thereby limiting their value in a crisis.[9]

6-2b Organizing the Enterprise

After goal-setting and planning, the manager's second major function is organization. **Organizing** is the grouping of resources and activities to accomplish some end result in an efficient and effective manner. Consider the case of an inventor who creates a new product and goes into business to sell it. At first, the inventor will do everything—purchase raw materials, make the product, advertise it, sell it, and keep business records. Eventually, as business grows, the inventor will need help. To begin with, the inventor might hire a professional sales representative and a part-time bookkeeper. Later, it also might be necessary to hire sales staff, people to assist with production, and an accountant. As new

contingency plan a plan that outlines alternative courses of action that may be taken if an organization's other plans are disrupted or become ineffective

organizing the grouping of resources and activities to accomplish some end result in an efficient and effective manner personnel are hired, the inventor must decide what each person will do, to whom each person will report, and how each person can best take part in the organization's activities. We discuss these and other facets of the organizing function in much more detail in Chapter 7.

6-2c Leading and Motivating

The leading and motivating function is concerned with an organization's human resources. Specifically, **leading** is the process of influencing people to work toward a common goal. **Motivating** is the process of providing reasons for people to work in the best interests of an organization. Together, leading and motivating are often referred to as **directing**.

Leading and motivating are critical activities because of the importance of an organization's human resources. Obviously, different people do things for different reasons—that is, they have different *motivations*. Some are interested primarily in earning as much money as they can. Others may be spurred on by opportunities to get promoted. Part of a manager's job, then, is to determine what factors motivate workers and to try to provide those incentives to encourage effective performance. Many people choose to work at Cisco because of its reputation for treating its employees well (it has been on *Fortune's* Best Companies to Work For list for more than two decades), and they want to be part of a major information technology company with strong growth potential. In addition to a competitive compensation plan and bonuses, Cisco provides generous benefits—such as tuition reimbursement, flexible work options, subsidized childcare, onsite fitness and medical facilities, and lengthy maternity and paternity leave and support—and strives to create fun workspaces.[10] A lot of research has been done on both motivation and leadership. As you will see in Chapter 10, research on motivation has yielded very useful information. However, research on leadership has been less successful. Despite decades of study, no one has discovered a general set of personal traits or characteristics that makes a good leader. Later in this chapter, we discuss leadership in more detail.

Believe
In
Yourself

ISTOCK.COM/OGICHOBANOV

Encouraging employees is part of motivating them. Organizations employ numerous motivational messages. There are considerable differences among people regarding the factors and messages that motivate them.

leading the process of influencing people to work toward a common goal

motivating the process of providing reasons for people to work in the best interests of an organization

directing the combined processes of leading and motivating

controlling the process of evaluating and regulating ongoing activities to ensure that goals are achieved

6-2d Controlling Ongoing Activities

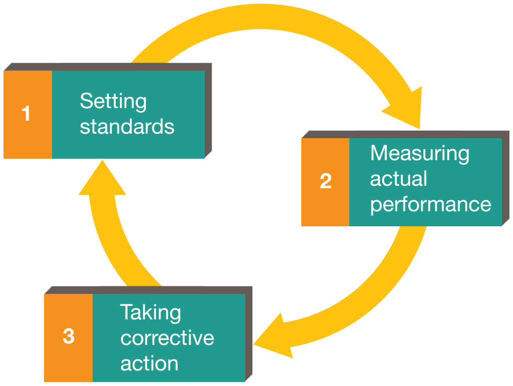
Controlling is the process of evaluating and regulating ongoing activities to ensure that goals are achieved. The control function includes three steps (refer to Figure 6-5). The first is *setting standards* against which performance can be compared. The second is *measuring actual performance* and comparing it with the standard. The third is *taking corrective action* as necessary. Notice that the control function is circular in nature. The steps in the control function must be repeated periodically until the goal is achieved. For example, suppose that Southwest Airlines establishes a goal of increasing profits by 12 percent. Southwest's management will monitor its profit on a monthly basis to ensure success. After three months, if profit has increased by 3 percent, management may assume that plans are effective. In this case, no action will likely be taken. However, if profit has increased by only 1 percent, some corrective action will be needed to get the firm on track. The action that is required depends on the reason for the less-than-expected increase.

A LITTLE PROGRESS
EACH DAY ADDS UP TO
BIG RESULTS

ISTOCK.COM/COOMPIA77

Figure 6-5 The Control Function

The control function includes three steps: setting standards, measuring actual performance, and taking corrective action.



✓ Concept Check

- Why is planning sometimes referred to as the "first" management function?
- What is a plan? Differentiate among the major types of plans.
- What kind of motivations do different employees have?
- What are the three steps of controlling?

6-3 Kinds of Managers

Learning Objective

6-3 Distinguish among the various kinds of managers in terms of both level and area of management.

Managers can be classified in two ways: according to their level within an organization and according to their area of management. In this section, we use both perspectives to explore the various types of managers.

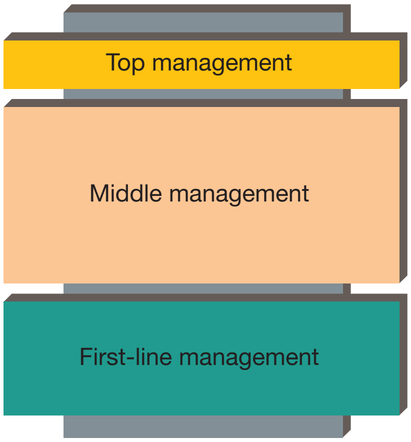
6-3a Levels of Management

For the moment, think of an organization as a three-story structure (as illustrated in Figure 6-6). Each story corresponds to one of the three general levels of management: top managers, middle managers, and first-line managers.

Top Managers A **top manager** is an upper-level executive who guides and controls an organization's overall fortunes. Top managers represent the smallest of the three groups. In terms of planning, they are generally responsible for developing the

Figure 6-6 Management Levels Found in Most Companies

The coordinated effort of all three levels of managers is required to implement the goals of any company.



top manager an upper-level executive who guides and controls the overall fortunes of an organization

JASON REDMOND/AFP/GETTY IMAGES

Top manager. As the first Black woman CEO of a Fortune 500 company, Rosalind Brewer is certainly on a roll. Brewer began her journey to success by working as a research technician for a paper manufacturer for 22 years. Frustrated by the lack of control she had in research and development there, she transferred to administration, where she moved up to the role of president for manufacturing and global operations. From there, she joined Walmart as a regional vice president in 2006, then eventually became president of Walmart East. Of course, she didn't just stop there. In 2012, she became the president and CEO of Sam's Club. Then in 2017, she migrated to the role of COO for Starbucks, earning herself a spot in *Fortune* magazine as one of the 50 Most Powerful Women in Business. Today, she is the CEO of Walgreens where she continues to be a powerhouse in the business world.

organization's mission. They also determine the firm's strategy. It takes years of hard work, long hours, and perseverance; talent; and no small share of good luck to reach the ranks of top management in large companies. Common job titles associated with top managers are president, vice president, chief executive officer (CEO), and chief operating officer (COO). These are often referred to as the "C-suite" because so many of the titles begin with the letter "C."

Middle Managers Middle managers make up the largest group of managers in most organizations. A **middle manager** is a manager who implements the strategy and major policies developed by top management. Middle managers develop tactical and operational plans, and they coordinate and supervise the activities of first-line managers. Titles at the middle-management level include division manager, department head, plant manager, and operations manager.

First-Line Managers A **first-line manager** is a manager who coordinates and supervises the activities of operating employees. First-line managers spend most of their time working with and motivating their employees, answering questions, and solving day-to-day problems. Most first-line managers are former operating employees who were promoted into management. Many of today's middle and top managers began their management careers on this first management level. Common titles for first-line managers include office manager, supervisor, and foreman.

6-3b Areas of Management Specialization

Organizational structure can also be divided into areas of management specialization (refer to Figure 6-7). The most common areas are finance, operations, marketing, human resources, and administration. Depending on its mission, goals, and objectives, an organization may include other areas as well—research and development (R&D), for example.

Financial Managers A **financial manager** is primarily responsible for an organization's financial resources. Accounting and investment are specialized areas within financial management. Because financing affects the operation of the entire firm, many CEOs and presidents of large companies are people who were first trained as financial managers.

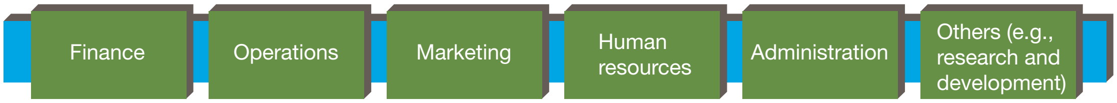
middle manager a manager who implements the strategy and major policies developed by top management

first-line manager a manager who coordinates and supervises the activities of operating employees

financial manager a manager who is primarily responsible for an organization's financial resources

Figure 6-7 Areas of Management Specialization

Other areas may have to be added, depending on the nature of the firm and the industry.



ISTOCK.COM/MILAN MARKOVIC

Harnessing the cooperation of an organization's specialized managers. Imagine the managers of different departments as a team of horses. If they—and their employees—don't all work together and pull in the same direction, the organization won't get to the destination it is trying to reach.

Operations Managers An **operations manager** manages the systems that convert resources into goods and services. Traditionally, operations management has been equated with manufacturing—the production of goods. However, in recent years, many of the techniques and procedures of operations management have been applied to the production of services and to a variety of nonbusiness activities. As with financial management, operations management has produced a large percentage of today's company CEOs and presidents.

Marketing Managers A **marketing manager** is responsible for facilitating the exchange of products between an organization and its customers or clients. Specific areas within marketing are marketing research, product management, advertising, promotion, sales, and distribution. A sizable number of today's company presidents have risen from marketing management.

Human Resources Managers A **human resources manager** is charged with managing an organization's human resources programs. This individual engages in human resources planning; designs systems for hiring, training, and evaluating the performance of employees; and ensures that the organization follows government regulations concerning employment practices. There are many technological tools to help human resources managers. For example, Workday, Inc. produces a suite of software and tools for human resources departments, including a program to streamline the recruiting and hiring process and tools that help HR managers collect and process information.

Administrative Managers An **administrative manager** (also called a *general manager*) is not associated with any specific functional area but provides overall administrative guidance and leadership. Hospital administrators are an example of administrative managers. They do not specialize in operations, finance, marketing, or human resources management but instead coordinate the activities of specialized managers in all these areas. In many respects, most top managers are really administrative managers.

Whatever their level and specialization in the organization, successful managers generally exhibit certain key skills and are able to play a variety of managerial roles. However, as we shall see, some skills are likely to be more critical at one level of management than at another.

✓ Concept Check

- Describe the three levels of management.
- Identify the various areas of management specialization and describe the responsibilities of each.

operations manager a manager who manages the systems that convert resources into goods and services

marketing manager a manager who is responsible for facilitating the exchange of products between an organization and its customers or clients

human resources manager a person charged with managing an organization's human resources programs

administrative manager a manager who is not associated with any specific functional area but who provides overall administrative guidance and leadership

Ethics and Social Responsibility

Radical Transparency at Everlane Goes Bust

Everlane, a direct-to-consumer clothing company, promised radical transparency. The company said it would reveal pricing markups, its clothing suppliers, and its ecological impact. But now, current and former employees say Everlane's ethical image was an illusion. Employees accuse Everlane of union-busting, racism, and of selling a false ethical image to the world.

With Everlane's corporate culture under the microscope, Michael Preysman, founder and CEO, launched an internal investigation that confirmed many of the complaints. Investigators found that new hires felt unwelcome, that leaders used inappropriate terms when referring to people of color, that there was no procedure for submitting harassment and discrimination claims, and more. In response, Preysman expressed the desire to revisit the company's code of ethics. Additionally, the company committed to several diversity initiatives such as hiring a Black board member, diversifying the senior leadership team, and introducing anti-racism training.

To top it off, Everlane's commitments to ethical labor and sustainability have attracted criticism as well. Brand ratings platform Good on You gave Everlane a "not good enough" overall rating for failing to adequately track greenhouse gas emissions, reduce water use, and guarantee living wages. Consumers and employees are increasingly attracted to companies that share their values. When a company such as Everlane fails to deliver on its promises, its stakeholders lose trust in the organization. Everlane's management will have to redefine what it means to be radically transparent and recommit to living out the firm's values.

Sources: Based on information in Jessica Testa, Vanessa Friedman, and Elizabeth Paton, "Everlane's Promise of 'Radical Transparency' Unravels," *The New York Times*, July 26, 2020, www.nytimes.com/2020/07/26/fashion/everlane-employees-ethical-clothing.html; Kaley Roshitsh, "Everlane, Reformation Respond to Callouts in Remake Transparency Report," *WWD*, December 9, 2020, www.wwd.com/sustainability/business/everlane-reformation-transparency-remake-report-callouts-1234672485/; Elizabeth Segran, "Everlane Is the Latest Company to Come Under Fire for a Toxic Workplace," *Fast Company*, January 8, 2020, www.fastcompany.com/90449436/everlane-is-the-latest-company-to-come-under-fire-for-a-toxic-workplace.

6-4 Key Skills of Successful Managers

Learning Objective

6-4 Recognize the key management skills of successful managers.

As shown in Figure 6-8, managers need a variety of skills, including conceptual, analytic, interpersonal, technical, and communication skills.

6-4a **Conceptual Skills**

Conceptual skills involve the ability to think in abstract terms. Conceptual skills allow a manager to see the "big picture" and understand how the various parts of an organization or idea can fit together. Consider Jeff Bezos, who founded and led Amazon for many years (he now serves as its executive chair). Despite media and investor criticism during the many years Amazon operated in the red, Bezos never lost sight of his vision of an internet commerce site where people could shop quickly and easily. His strict long-term focus on the customer ensured that Amazon would eventually fulfill that vision. Conceptual skills are useful in a wide range of situations, including the optimization of goals described earlier.

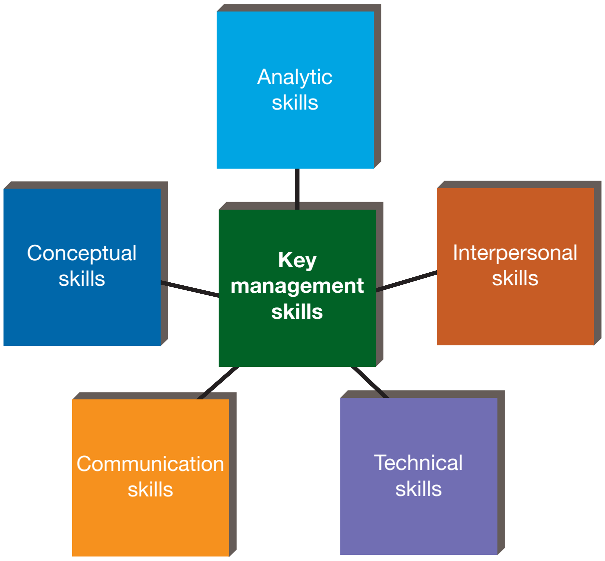
6-4b **Analytic Skills**

Employers expect managers to use **analytic skills** to identify problems correctly, generate reasonable alternatives, and select the "best" alternatives to solve problems. Top-level managers especially need these skills because they must discern the important issues from the less important ones, as well as recognize the underlying reasons for different situations. Soon after Mary Barra became the CEO of General Motors, she faced a crisis related to defective ignition switches in some GM vehicles,

conceptual skills the ability to think in abstract terms

analytic skills the ability to identify problems correctly, generate reasonable alternatives, and select the "best" alternatives to solve problems

Figure 6-8 Key Skills of Successful Managers



which ultimately caused hundreds of deaths and injuries. She quickly established a crisis team and launched an independent investigation. After analyzing the situation, she chose to fire a number of employees who she felt failed to act; and she had GM apologize for the faulty switches, set up a multimillion-dollar victim's compensation fund, and pay out millions of dollars to settle claims related to the scandal. After determining that General Motors' "toxic culture" had prevented employees from speaking up about the faulty ignition switches before they caused harm, she set about changing that culture. She began that process by modeling the behaviors she wanted to see. She also applied her analytic skills to turning around the automaker by taking actions such as selling an underperforming division and investing in new automotive technologies.[11] Managers who use these skills not only address a situation but also correct the initial event or problem that caused it to occur. Thus, these skills are vital to running a business efficiently and logically.

6-4c Interpersonal Skills

Interpersonal skills, also known as soft skills or people skills, involve the ability to deal effectively with other people, both inside and outside an organization. Examples of interpersonal skills are the ability to listen to and build relationships with people, understand their needs and motives, and show genuine compassion. Conflict resolution, patience, and diplomacy are also useful skills for today's leaders.

6-4d Technical Skills

Technical skills involve specific skills needed to accomplish a specialized activity. For example, engineers and machinists need technical skills to do their jobs. First-line managers (and, to a lesser extent, middle managers) need to understand the technical skills relevant to the activities they manage in order to train subordinates, answer questions, and provide guidance, even though the managers may not perform the technical tasks themselves. In general, top managers do not rely on technical skills as heavily as managers at other levels. Still, understanding the technical side of a business is an aid to effective management at every level.

interpersonal skills the ability to deal effectively with other people

technical skills specific skills needed to accomplish a specialized activity

Technology and Innovation

Will AI Replace Managers?

Artificial intelligence (AI) involves computers performing tasks that traditionally require human intelligence. AI has a broad set of applications, from AI-enabled inventory-tracking robots to AI-powered customer service chats. Hilton, for example, uses AI to simplify its recruiting process. This has caused many people to question if the technology will bring more management-free organizations. While AI can perform many managerial duties, it's more likely that humans and AI will exist side-by-side for many years to come.

AI may influence organizational design that fosters innovation and experimentation. In the future, managers may no longer be expected to perform administrative tasks but rather focus on their human skills such as creativity and innovation, things AI hasn't mastered. Managers would have more time to build relationships with their employees. According to a study by Oracle and Future Workplace, employees think robots are better at providing unbiased information while managers are better at understanding feelings. By taking administrative tasks away and streamlining processes, AI stands to increase employee productivity and allow organizations to operate at a faster pace.

AI isn't replacing managers just yet. Rather, AI is supplementing management and freeing managers to focus on more critical tasks. Managers will need to balance resources, invest in reskilling employees, and advance new models of education, creating pathways to continuous learning. Leaders must embrace the challenges AI brings to properly prepare the workforce of tomorrow.

Sources: Based on information in Martin Fleming, "AI Is Changing Work—and Leaders Need to Adapt," *Harvard Business Review*, March 24, 2020, www.hbr.org/2020/03/ai-is-changing-work-and-leaders-need-to-adapt; Dan Schawbel, "How Artificial Intelligence Is Redefining the Role of Manager," *World Economic Forum*, November 15, 2019, www.weforum.org/agenda/2019/11/how-artificial-intelligence-is-redefining-the-role-of-manager/; Joe McKendrick, "Artificial Intelligence May Bring More Management-Free Organizations," *Forbes*, June 8, 2020, www.forbes.com/sites/joemckendrick/2020/06/08/artificial-intelligence-may-bring-more-management-free-organizations-but-not-for-the-reason-you-think/.

6-4e **Communication Skills**

Communication skills, both oral and written, involve the ability to speak, listen, and write effectively. Managers need both oral and written communication skills. Because a large part of a manager's day is spent conversing with others, the ability to speak *and* listen is critical. Oral communication skills are used when a manager makes sales presentations, conducts interviews, and holds press conferences. Written communication skills are important because a manager's ability to prepare letters, emails, memos, sales reports, and other written documents may spell the difference between success and failure. Computers, smartphones, and other high-tech devices make communication in today's businesses easier and faster. To manage an organization effectively and to stay informed, it is very important that managers understand how to use and maximize the potential of digital communication devices.

✓ Concept Check

- What are the key skills that successful managers should have?
- For each skill, provide two reasons why a successful manager should have that skill.

6-5 Leadership

Learning Objective

6-5 Identify the different types of leadership.

Leadership has been defined broadly as the ability to influence others. Leadership is different from management in that a leader strives for voluntary cooperation, whereas a manager may have to depend on coercion to change employee behavior.

6-5a **Formal and Informal Leadership**

Some experts make distinctions between formal leadership and informal leadership. Formal leaders have legitimate power of position. They have *authority* within an organization to influence others to work toward the organization's objectives.

communication skills the ability to speak, listen, and write effectively

leadership the ability to influence others

Informal leaders usually have no such authority and may or may not exert their influence in support of the organization. Both formal and informal leaders make use of several kinds of power, including the ability to grant rewards or impose punishments, the possession of expert knowledge, and personal attraction or charisma. Informal leaders who identify with the organization's goals are a valuable asset to any organization. However, a business can be greatly hampered by informal leaders who turn work groups against management.

ISTOCK.COM/ANDREYPOPOV

How good are your managerial skills? To be successful, managers must master and simultaneously utilize a number of skills. These include technical skills that aid with specialized work, conceptual skills that foster abstract thinking, and interpersonal skills to help manage and motivate employees. Which of these skills will you need to work on as you build your career?

6-5b Styles of Leadership

For many years, finding a consensus on the most important leadership traits was difficult. Leadership was viewed as a combination of personality traits, such as self-confidence, concern for people, intelligence, and dependability. In recent years, the emphasis has been on styles of leadership. Several styles have emerged, including autocratic, participative, laissez-faire, transformational, transactional, and charismatic.

Autocratic leadership, also called authoritative leadership, is a hands-on, task-oriented leadership style. These leaders make decisions unilaterally, with little concern for employee opinions or knowledge. Employees are told exactly what is expected from them and given specific guidelines, rules, and regulations on how to achieve their tasks. Strict compliance is expected.

Participative leadership, which involves all members of a team identifying essential goals and developing strategies to reach those goals, is common in today's business organizations. Participative leaders consult workers before making decisions and make final decisions based on their support, though they retain final authority for decision making. This helps workers understand which goals are important and fosters a sense of ownership and commitment to reach them. Communication is open up and down the hierarchy. Coaching, collaborating, and negotiating are important skills for participative leaders.

Laissez-faire leadership, also known as free-rein leadership, is a hands-off leadership style. These leaders provide general direction along with tools and resources and then delegate responsibility and decision making to subordinates. As long as employees are satisfying expectations, these leaders expect them to apply their own skills and knowledge to furthering the goals of the organization. Warren Buffett, CEO and chief investor of Berkshire Hathaway, is a famously laissez-faire leader.

Transformational leadership recognizes that today's competitive landscape requires challenging the status quo with new ideas. These leaders promote communication and transparency with high expectations while providing support and recognition to subordinates. Many of the industry disruptors of recent years, including Google's Larry Page and Dollar Shave Club's Michael Dubin, provided transformational leadership to develop new business models.

Transactional leadership is a leadership style that emphasizes structure, monitoring employee performance, and using rewards and punishments to motivate subordinates to achieve organizational goals. These leaders tend to focus on the chain of command, productivity, and efficiency. They generally try to be considerate of subordinates because doing so can improve productivity. Transactional leadership is especially common in sports teams though it is often found in business organizations as well.

Finally, **charismatic leadership** is personality dependent. These leaders influence, inspire, and motivate employees to perform due to their own innate charm

autocratic leadership task-oriented leadership style in which workers are told what to do and how to accomplish it without having a say in the decision-making process

participative leadership leadership style in which all members of a team are involved in identifying essential goals and developing strategies to reach those goals

laissez-faire leadership a hands-off leadership style that provides direction, tools, and resources to employees while delegating responsibility and decision-making authority to them

transformational leadership leadership style that focuses on transforming organizations and industries

transactional leadership leadership style that emphasizes structure, performance and productivity, and reward systems

charismatic leadership personality-dependent leadership style

Exploring Careers

Top Traits of Good Managers, According to Google

Having great managers and leaders can improve productivity and employee retention. Google conducted research to discover what makes the perfect manager with the goal of training its leaders to develop those qualities and behaviors. The tech giant was able to successfully identify a series of traits that good managers should have.

Google found that good leaders are also good coaches and use problems as teaching moments. Rather than micromanage employees, great managers empower their teams and give them the freedom to explore their ideas and take risks. At the same time, leaders should create a psychologically safe environment where employees feel free from embarrassment or punishment for making mistakes and asking questions.

Good managers are productive and results-oriented, but, perhaps more importantly, they are good communicators who show empathy. They support the success of their team members, but they aren't afraid to provide constructive criticism. Great managers, being results-oriented, have a vision for the team's future as well as the technical skills necessary to advise the team. Google also found that managers shouldn't just lead—they should collaborate. Finally, good managers are decisive and commit to their decisions.

While it may be challenging to hire a manager that exhibits all of these characteristics and behaviors, Google has been able to train its leaders and use this knowledge to improve employee retention, satisfaction, and performance. Ten years of research have paid off.

Sources: Based on information in Justin Bariso, "10 Traits of a 'Perfect' Boss, According to Research by Google," *Business Insider*, August 1, 2020, www.businessinsider.com/the-best-bosses-do-these-things-according-to-google-2019-6; Poppy Noor, "Google Released Research on What Makes a Good Boss - Do You Agree?" *The Guardian*, October 21, 2019, www.theguardian.com/money/2019/oct/21/google-released-research-on-what-makes-a-good-boss-do-you-agree; "Learn About Google's Manager Research," re:Work, rework.withgoogle.com/guides/managers-identify-what-makes-a-great-manager/steps/learn-about-googles-manager-research/.

KIYOSHI OTA/BLOOMBERG/GETTY IMAGES

Playing multiple leadership roles. Elon Musk, co-founder and CEO of Tesla, provides leadership in product design, engineering, and global manufacturing. At Space X, he oversees the development of rockets and spacecraft. At Neuralink, he provides top level leadership aimed at developing ultra-high bandwidth brain-machine interfaces to connect the human brain to computers. His leadership at The Boring Company focuses on providing low-cost tunneling technology for use in urban transportation.

and personality. They tend to be idealistic and forward-thinking and model behavior that reflects their high expectations. Oprah Winfrey and the late Steve Jobs are well-known examples of charismatic leaders who inspired their subordinates to perform very well in competitive industries.

6-5c Which Leadership Style Is the Best?

Today, most management experts agree that no "best" managerial leadership style exists. Each of the styles described—autocratic, participative, laissez-faire, transformational, transactional, and charismatic—has advantages and disadvantages. For example, participative leadership can motivate employees to work effectively because they have a sense of ownership in decision making. However, the decision-making process in participative leadership takes time that subordinates could be devoting to the work itself. In a similar vein, autocratic leaders can be very effective during times of crisis. However, outside of such times, their leadership can stifle the creativity of subordinates that could otherwise benefit the organization.

Although hundreds of research studies have been conducted to prove which leadership style is best, there are no definite conclusions. Each of the leadership styles can be highly effective in the right situation. The *most* effective style depends on the right balance between interaction among employees, characteristics of the work situation, and the manager's personality.

✓ Concept Check

- Describe the major leadership styles.
- Which one is best?

6-6 Managerial Decision Making

Learning Objective

6-6 Discuss the steps in the managerial decision-making process.

Decision making is the act of choosing one alternative from a set of alternatives.[12] In ordinary situations, decisions are made casually and informally. We encounter a problem, mull it over, settle on a solution, and go on. Managers, however, require a more systematic method for solving complex problems. As shown in Figure 6-9, the managerial decision-making process involves four steps: (1) identifying the problem or opportunity, (2) generating alternatives, (3) selecting an alternative, and (4) implementing and evaluating the solution.

6-6a Identifying the Problem or Opportunity

A **problem** is the discrepancy between an actual condition and a desired condition—the difference between what is occurring and what one wishes would occur. For example, a marketing manager at Campbell Soup Company has a problem if sales revenues for its Pepperidge Farm Goldfish crackers are declining (the actual condition). To solve this problem, the marketing manager must take steps to increase sales revenues (desired condition). Most people consider a problem to be "negative," but a problem also can be "positive." Some problems can be viewed as "opportunities." Consider the success of plant-based meat alternatives such as Beyond Meat and Impossible Foods, which highlighted a surprising market—consumers increasingly willing to try meat alternatives to be healthier and kinder to the environment. Although meat producers could have viewed these new competitors as a threat, Tyson, Perdue, Hormel, and others saw an opportunity to reach these consumers. Hormel introduced a plant-based ground meat product, while Nestlé introduced the Awesome Burger. Tyson and Perdue both launched part meat, part plant products such as "chicken" nuggets.[13]

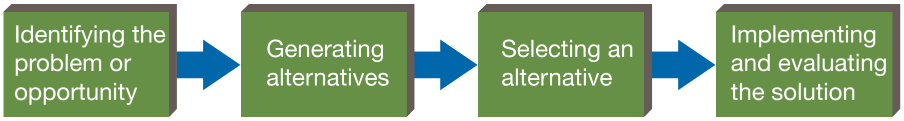
ISTOCK.COM/NUIIKO

Although accurate identification of a problem is essential before it can be solved or turned into an opportunity, this stage of decision making creates many difficulties for managers. Sometimes managers' preconceptions of the problem prevent them from seeing the actual situation. They produce an answer before the proper question has been asked, leading them to focus on insignificant issues. Also, managers may mistakenly analyze problems in terms of symptoms rather than underlying causes.

Effective managers learn to look ahead so that they are prepared when decisions must be made. They clarify situations and examine the causes of problems, asking whether the presence or absence of certain variables alters a situation. Finally, they consider how individual behaviors and values affect the way problems or opportunities are defined.

Figure 6-9 Major Steps in the Managerial Decision-Making Process

Managers require a systematic method for solving problems in a variety of situations.


Identifying the problem or opportunity
Generating alternatives
Selecting an alternative
Implementing and evaluating the solution

decision making the act of choosing one alternative from a set of alternatives

problem the discrepancy between an actual condition and a desired condition

Entrepreneurial Success

Jeff Bezos Reveals His Secret to Making High-Stakes Decisions

Managers are faced with making tough decisions on a daily basis, but every leader has their own style of decision making. Jeff Bezos, founder and executive chairman of Amazon, says his secret is to make a small number of high-quality decisions and to plan three years out.

Bezos believes executives shouldn't be making thousands of decisions each day. Instead, they should make fewer, better decisions. One key, he says, to making the right choices quickly is determining if a decision is a one-way door or a two-way door. One-way door decisions are irreversible and highly consequential, so you do not want to make the decision quickly. Two-way door decisions, on the other hand, can be reversed and adjusted, so employees and managers don't need to spend as much time analyzing outcomes.

Another way to speed up decision making is to escalate controversial decisions to senior managers. When teams are gridlocked, making a decision can feel like going to war. Rather than allowing junior employees to argue and become demoralized, senior leaders can make the call after hearing various points of view. Leaders can respectfully disagree and challenge decisions, but at the end of the day, Bezos says everyone needs to agree to disagree and wholly commit to the final decision.

Bezos's philosophy on making high-stakes decisions is supported in Amazon's leadership principle "bias for action," which speaks to the importance of speed in making decisions and taking action. Whether you're managing a huge company like Amazon or a small start-up, it can be nearly impossible to have enough time to consider all information when it comes to decision making. Bezos believes his decision-making style is his key to success.

Sources: Based on information in Buster Benson, "Ex-Amazon Manager: Jeff Bezos Is 'Obsessed' with This Decision-Making Style—'It's His Key to Success,'" *CNBC*, November 14, 2019, www.cnbc.com/2019/11/14/how-billionaire-jeff-bezos-makes-fast-smart-decisions-under-pressure-says-ex-amazon-manager.html; Amazon, "Leadership Principles," www.amazon.jobs/en/principles; Jeff Bezos, "Jeff Bezos: Here's How I Make Amazon's Highest-Stakes Decisions," *Fast Company*, November 23, 2020, https://www.fastcompany.com/90578272/how-jeff-bezos-makes-decisions.

6-6b **Generating Alternatives**

After a problem has been defined, the next task is to generate alternatives. The more important the decision, the more attention must be devoted to this stage. Managers should be open to fresh, innovative ideas as well as obvious answers.

Certain techniques can aid in the generation of creative alternatives. Brainstorming, commonly used in group discussions, encourages participants to produce many new ideas. During brainstorming, other group members are not permitted to criticize or ridicule. Another approach, developed by the U.S. Navy, is called "Blast! Then Refine." Group members tackle a recurring problem by erasing all previous solutions and procedures. The group then reevaluates its original objectives, modifies them if necessary, and devises new solutions. Other techniques—including trial and error—are also useful in this stage of decision making.

6-6c **Selecting an Alternative**

Final decisions are influenced by a number of considerations, including financial constraints, human and informational resources, time limits, legal obstacles, and political factors. Managers must select the alternative that will be most effective and practical.

At times, two or more alternatives or some combination of alternatives will be equally appropriate. Managers may choose solutions to problems on several levels. The word *satisfice* describes solutions that are only adequate and not ideal. When lacking time or information, managers often make decisions that "satisfice." Whenever possible, managers should try to investigate alternatives carefully and select the ideal solution.

6-6d **Implementing and Evaluating the Solution**

Implementation of a decision requires time, planning, preparation of personnel, and evaluation of results. Managers usually deal with unforeseen consequences even when they have carefully considered the alternatives.

The final step in managerial decision making entails evaluating a decision's effectiveness. If the alternative that was chosen removes the difference between the actual condition and the desired condition, the decision is considered effective. If the problem still exists, managers may select one of the following choices:

- Decide to give the chosen alternative more time to work.
- Adopt a different alternative.
- Start the problem identification process all over again.

Managers should be aware that failure to evaluate decisions adequately may have negative consequences.

✓ Concept Check

- Describe the major steps in the managerial decision-making process.
- Why does a manager need to evaluate the solution and look for problems after a solution has been implemented?

Summary

6-1 Define management.

Management is the process of coordinating people and other resources to achieve an organization's goals. Managers are concerned with four types of resources—material, human, financial, and informational.

6-2 Describe the four basic management functions: planning, organizing, leading and motivating, and controlling.

Managers perform four basic functions, which do not occur according to a rigid, preset timetable. At any time, managers may engage in a number of functions simultaneously. However, each function tends to lead naturally to the next. Managers engage in planning—determining where the firm should be going and how best to get there. One method of planning that can be used is SWOT analysis, which identifies and evaluates a firm's strengths, weaknesses, opportunities, and threats. Three types of plans, from the broadest to the most specific, are strategic, tactical, and operational. Managers also organize resources and activities to accomplish results in an efficient and effective manner, and they lead and motivate others to work in the best interests of the organization. In addition, managers control ongoing activities to keep the organization on course. There are three steps in the control function: setting standards, measuring actual performance, and taking corrective action.

6-3 Distinguish among the various kinds of managers in terms of both level and area of management.

Managers—or management positions—may be classified from two different perspectives. From the perspective of level within the organization, there are top managers, who control the organization as a whole; middle managers, who implement strategies and major policies; and first-line managers, who supervise the activities of operating employees. From the viewpoint of area of management, managers most often deal with the areas of finance, operations, marketing, human resources, and administration.

6-4 Recognize the key management skills of successful managers.

Managers need a variety of skills in order to run a successful and efficient business. Conceptual skills are used to think in abstract terms or see the "big picture." Analytic skills are used to identify problems correctly, generate reasonable alternatives, and select the "best" alternatives to solve problems. Interpersonal skills are used to deal effectively with other people, both inside and outside an organization. Technical skills are needed to accomplish a specialized activity, whether they are used to actually do the task or to train and assist employees. Communication skills are used to speak, listen, and write effectively.

6-5 Identify the different types of leadership.

Managers' effectiveness often depends on their styles of leadership—that is, their ability to influence others, either formally or informally. Autocratic leaders are very task oriented; they tell their employees exactly what is expected from them and give them specific instructions on how to do their assigned tasks. Participative leaders consult their employees before making decisions and can be classified into three groups: consultative, consensus, and democratic. Laissez-faire leaders are very hands off; they provide general direction along with tools and resources and then delegate responsibility and decision making to subordinates. Transformational leaders recognize that today's competitive landscape requires challenging the status quo with new ideas. Transactional leaders emphasize structure, monitoring employee performance, and using rewards and punishments to motivate subordinates to achieve organizational goals. Finally, charismatic leaders influence, inspire, and motivate employees to perform due to their own innate charm and personality.

6-6 Discuss the steps in the managerial decision-making process.

Decision making, an integral part of a manager's work, is the process of developing a set of possible alternative solutions to a problem and choosing one alternative from among the set. Managerial decision making involves four steps: Managers must accurately identify problems, generate several possible solutions, choose the solution that will be most effective under the circumstances, and implement and evaluate the chosen course of action.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

management (164)
planning (165)
mission (166)
strategic planning process (166)
goal (166)
objective (166)
SWOT analysis (167)
core competencies (167)
plan (167)
strategic plan (167)
tactical plan (168)
operational plan (168)
contingency plan (169)
organizing (169)
leading (170)
motivating (170)
directing (170)
controlling (170)
top manager (171)
middle manager (172)
first-line manager (172)
financial manager (172)
operations manager (173)
marketing manager (173)
human resources manager (173)
administrative manager (173)
conceptual skills (174)
analytic skills (174)
interpersonal skills (175)
technical skills (175)
communication skills (176)
leadership (176)
autocratic leadership (177)
participative leadership (177)
laissez-faire leadership (177)
transformational leadership (177)
transactional leadership (177)
charismatic leadership (177)
decision making (179)
problem (179)

Discussion Questions

1. Define the word *manager* without using the word *management* in your definition.
2. Does a healthy firm (one that is doing well) have to worry about effective management? Explain.
3. What might be the mission of a neighborhood restaurant? Of the Salvation Army? What might be reasonable objectives for these organizations?
4. What are the major elements of SWOT analysis?
5. How do a strategic plan, a tactical plan, and an operational plan differ? What do they all have in common?
6. Should all firms have contingency plans? Why or why not?
7. Why are leadership and motivation necessary in a business in which people are paid for their work?
8. Compare and contrast the major styles of leadership.
9. According to this chapter, the leadership style that is most effective depends on interaction among the employees, characteristics of the work situation, and the manager's personality. Do you agree or disagree? Explain your answer.
10. Do you think that people are really as important to an organization as this chapter seems to indicate?
11. Discuss what happens during each of the four steps of the managerial decision-making process.

Case 6

Tesla: From Start-Up to Wall Street Darling

Tesla is one of the most valuable car makers in the world. The company, which also makes energy generation products, has a reputation for industry-disrupting innovation, but Tesla wasn't an overnight success. Tesla was founded by engineers Martin Eberhard and Marc Tarpenning in 2003, the same year General Motors discontinued its EV1, citing a lack of demand for electric vehicles (EVs). They sold their e-book business to start Tesla and build a greener car—a high-end performance EV for wealthy car enthusiasts.

Elon Musk joined the company in 2004 with an investment of $30 million and became the chair of the board of directors. The company's plan was to focus its efforts on lithium-ion batteries, which were cheaper and more powerful than the batteries used in previous EVs. They planned to create a high-margin, high-performance sports car to get away from the stigma surrounding EVs at the time and use the revenue to fund a more affordable car in the long run. Another core goal was to achieve economies of scale to bring down the cost per unit.

Tesla spent many years testing and designing components and prototypes of what would become the Roadster. The company wanted to reduce the complexity in manufacturing, but costs spiraled out of control as the company customized more and more parts. Eberhard resigned as CEO in 2007 and was replaced by Ze'ev Drori, who pushed the company forward to finalize the long-awaited Roadsters. Eberhard and Tarpenning broke all ties with Tesla around the same time Roadsters finally went into production; they later suggested they had been forced out.

The next year, Eberhard sued both Tesla and Elon Musk, alleging Eberhard's leadership had been wrongly blamed for the company's early financial and operational struggles. Eberhard said Musk unfairly took credit for the Roadster. Musk offered Eberhard a small severance package, but Tesla rescinded the package after Eberhard created a blog post discussing Tesla employees. Tesla denied Eberhard's allegations, and he eventually dropped his lawsuit.

In 2008, Musk took the reins as CEO and made several big moves to save the company, including cutting 25 percent of the workforce, selling a 10 percent stake to Daimler AG, and borrowing $465 million from the U.S. government. Though only 2,450 Roadsters were made, they demonstrated that EVs could have a longer driving range and reach high speeds, making EVs more appealing to the mass market. Tesla's 2010 initial public offering (IPO) raised $226 million, showing that investors had confidence in the EV revolution.

With one successful vehicle under its belt, Tesla decided to go after the wider market with the Model S, the world's first premium all-electric sedan, in 2012 and the Model X, the safest SUV ever tested, in 2015. Both vehicles had impressive acceleration times and driving ranges, but the high cost of lithium-ion batteries was still weighing on the company. To reduce costs, Tesla brought battery cell production in-house with the creation of Gigafactory 1 outside of Sparks, Nevada. The cost of battery cells declined through economies of scale and the reduction of waste, making the vehicles more affordable for consumers.

Next, Tesla began to focus on the energy side of its business, introducing Solar Roof solar tiles and the Powerwall home battery. The company changed its name from Tesla Motors to Tesla, Inc. in 2017, to represent the company's shift from a car manufacturer to a sustainable energy solution company. The automaker's energy solutions enable homeowners, businesses, and utilities to manage renewable energy generation, storage, and consumption.

Tesla introduced the Model 3 in 2017, which was considered to be its first car for the masses. By 2018, the Model 3 had become the number-one selling plug-in car in the world, passing the Nissan Leaf by 2,000 units. In 2019, the company achieved Musk's goal of creating a more affordable EV for the broader market when it released a base model of the Model 3 at a price point of $35,000 for a limited time. Tesla continued to target the consumer market with its first compact crossover, the Model Y, and a new kind of pickup truck, the Cybertruck, in 2019. In addition to capturing more of the consumer market, Tesla is investing in heavy-duty trucks with Tesla Semi, an electric semitrailer truck that is designed to be far less expensive per mile than traditional semi-trucks. The truck accelerates faster and drives uphill faster than a traditional semi and includes advanced safety features.

Tesla, which has fumbled when it comes to setting expectations and meeting deadlines, will need to streamline its operations to be a contender in the mass car market. Investors continue to bet on the automaker with its stock reaching record highs. In fact, Tesla became the most valuable automaker in the world based on market value. The company's mission is to accelerate the world's transition to sustainable energy. Working to cover more forms of transport greatly expands Tesla's footprint in the automotive industry and improves the carbon footprint of the transportation industry as a whole.[14]

Questions

1. What strengths have contributed to Tesla's success?
2. Tesla planned to create a high-margin, high-performance sports car and use the revenue to fund a more affordable car in the long run. Was this plan successful? Why or why not?
3. How does Tesla live up to its mission?

Building Skills for Career Success

1. Social Media Exercise

Crowdsourcing is a set of principles, processes, and platforms to get things done that includes putting out an open call to a group and managing the responses and output. Crowdsourcing can be like outsourcing in a bigger way because instead of contracting to one known entity, you are putting a call out to a bigger group, often a global online community, either to get many to participate or to find the person you need by casting a much wider net.

There are crowdsourcing companies that perform specific types of work such as translations (Gengo, Smartling), transcription (CastingWords), even design and marketing work (99Designs, CrowdSpring). Each company operates differently. In the case of transcription or translation, you give work to a company like CastingWords or Gengo, and they in turn put the job out to their "crowd" of workers from around the world. They are like the middleman to helping you get the work done, and their distributed workforce can be less costly to them so they pass on their savings to your organization.

1. Check out a few of these crowdsourcing companies. What are your thoughts? Do you think they are effective? Why or why not?
2. Which type of leadership is most likely to include the use of crowdsourcing?
3. Can you think of other areas in businesses that can benefit from the use of crowdsourcing? What are they?

2. Building Team Skills

Over the past few years, an increasing number of employees, stockholders, and customers have demanded to know more about their companies. As a result, more companies have been taking the time to analyze their operations and to prepare mission statements that focus on the purpose of the company. The mission statement is becoming a critical planning tool for successful companies. To make effective decisions, employees must understand the purpose of their company.

Assignment

1. Divide into teams and write a mission statement for one of the following types of businesses:
   a. Food service, restaurant
   b. Banking
   c. Airline
   d. Auto repair
   e. Cabinet manufacturing.
2. Discuss your mission statement with other teams. How did the other teams interpret the purpose of your company? What is the mission statement saying about the company?
3. Write a one-page report on what you learned about developing mission statements.

3. Researching Different Careers

A successful career requires planning. Without a plan, or road map, you will find it very difficult, if not impossible, to reach your desired career destination. The first step in planning is to establish your career goal. You then must set objectives and develop plans for accomplishing those objectives. This kind of planning takes time, but it will pay off later.

Assignment

Complete the following statements:

1. My career goal is to:
   -

   This statement should encapsulate what you want to accomplish over the long run. It may include the type of job you want and the type of business or industry you want to work in. Examples include the following:
   - My career goal is to work as a top manager in the food industry.
   - My career goal is to supervise aircraft mechanics.
   - My career goal is to win the top achievement award in the advertising industry.
2. My career objectives are to:
   -
   -
   -
   -

   Objectives are benchmarks along the route to a career destination. They are more specific than a career goal. A statement about a career objective should specify what you want to accomplish, when you will complete it, and any other details that will serve as criteria against which you can measure your progress. Examples include the following:
   - My objective is to enroll in a management course at Main College in the spring semester 2022.
   - My objective is to earn an A in the management course at Main College in the spring semester 2022.
   - My objective is to be promoted to supervisor by January 1, 2023.
   - My objective is to prepare a status report by September 30 covering the last quarter's activities by asking Charlie in Quality Control to teach me the procedures.
3. Exchange your goal and objectives statements with another class member. Can your partner interpret your objectives correctly? Are the objectives concise and complete? Do they include criteria against which you can measure your progress? If not, discuss the problem and rewrite the objective.

Chapter 7

ISTOCK.COM/PEOPLEIMAGES

Creating a Flexible Organization

Learning Objectives

Once you complete this chapter, you will be able to:

7-1 Define an organization.

7-2 Explain why job specialization is important.

7-3 Identify the various bases for departmentalization.

7-4 Describe how decentralization follows from delegation.

7-5 Explore how the span of management describes an organization.

7-6 Identify four forms of organizational structure.

7-7 Examine the types, development, and uses of teams.

7-8 Describe how committees and task forces are used.

7-9 Explain the functions of the informal organization and the grapevine in a business.

Why Should You Care?

To operate a successful business, those in charge must create an organization that operates efficiently and is able to attract employees.

Inside Business

Coca-Cola Shakes It Up with a Reorganization Plan

The Coca-Cola Company, the world's largest soft drink company, announced plans to offer voluntary severance packages to about 4,000 of its most recently hired employees as it reorganizes its business segments and reorients its beverage strategy. Organizations often restructure to gain efficiencies and save money; however, reorganizations are costly upfront. Coca-Cola's severance program alone is expected to cost the company anywhere from $350 million to $550 million.

Under its previous structure, the beverage giant had 17 business units under four geographical departments, as well as Global Ventures and Bottling Investments. Now, Coca-Cola moves to nine new operating units under four geographical departments. This transition will combine regional and local execution in order to rapidly scale ideas and fuel innovation. Coca-Cola says the new structure is more streamlined and allows for interconnectivity and consistency, eliminating duplicated resources.

Coca-Cola also eliminated several brands to slim down its portfolio, including Tab, Zico, and Odwalla. The strategic structure shake-up serves to reinforce Coca-Cola's leadership in five product categories that the company believes have the strongest consumer opportunities: Coca-Cola; sparkling flavors; hydration, sports, coffee, and tea; nutrition, juice, milk, and plant; and emerging categories. Operating leaders will report to the president and chief operating officer while global category leads will report to the chief marketing officer. Coca-Cola recognizes that the market is fast-changing and expects this shift will drive future growth.[1]

Did You Know?

The Coca-Cola Company offers 500 brands in more than 200 countries and territories.

To survive and to grow, companies like Coca-Cola must constantly look for ways to improve their methods of doing business. Managers at Coca-Cola, like those at many organizations, maintain an organizational structure that best supports the achievement of company goals and the creation of innovative products that foster long-term customer relationships. When firms are organized, or reorganized, the focus is sometimes on achieving low operating costs. Other firms, such as L.L.Bean, emphasize providing high-quality products to ensure customer satisfaction. The issue of a firm's organizational structure is important because it can influence performance.

We begin this chapter by examining the business organization—what it is and how it functions in today's business environment. Next, we focus one by one on five characteristics that shape an organization's structure. We discuss job specialization within a company, the grouping of jobs into manageable units or departments, the delegation of power from management to workers, the span of management, and establishment of a chain of command. Then we step back for an overall view of organizational structure, the use and development of teams, and how committees and task forces are used. Finally, we look at the network of social interactions—the informal organization—that operates within the formal business structure.

organization a group of two or more people working together to achieve a common set of goals

7-1 What Is an Organization?

Learning Objective

7-1 Define an organization.

We used the term *organization* throughout Chapter 6 without really defining it, mainly because its everyday meaning is close to its business meaning. Here, however, let us agree that an **organization** is a group of two or more people working together to achieve a common set of goals. A neighborhood dry cleaner owned and operated by a husband-and-wife team is an organization. IBM and Home Depot, which employ thousands of workers worldwide, are also organizations. Although each corporation's organizational structure is more complex than the dry-cleaning establishment, all must be organized to achieve their goals.

ISTOCK.COM/MBORTOLINO

An inventor who goes into business to produce and market a new invention hires people, decides what each will do, determines who will report to whom, and so on. These activities are the essence of organizing, or structuring, the organization. An organization chart helps illustrate the shape of an organization.

An **organization chart** is a diagram that represents the positions and relationships within an organization. An example of an organization chart is shown in Figure 7-1. Each rectangle represents a particular position or person in the organization. At the top is the president, next are the vice presidents, and so on. The solid vertical lines connecting each level of the hierarchy indicate who is in the chain of command. The **chain of command** is the line of authority that extends from the highest to the lowest levels of the organization. You can see that each vice president reports directly to the president. Similarly, the plant managers, regional sales managers, and accounting department manager report to the vice presidents. An organization's chain of command can be short or long. A small local restaurant may have a very short chain of command consisting of the owner at the top and employees below. Large multinational corporations, on the other hand, may have very long chains of command. No matter what the length of the chain of command, organizations must ensure that communication along the chain is clear. Not everyone

organization chart a diagram that represents the positions and relationships within an organization

chain of command the line of authority that extends from the highest to the lowest levels of an organization

Entrepreneurial Success

Mikaila Ulmer Builds a Business to Save the Bees

Mikaila Ulmer started her business, Me & the Bees Lemonade, at just four years of age. A fear of bees quickly turned to fascination as she learned that honeybees are vital pollinators, yet they are dying at record rates. With her great-grandmother's flaxseed lemonade recipe in hand, Ulmer decided to sell honey-sweetened lemonade and donate a percentage of the profits to organizations fighting to save the honeybees. An appearance on ABC's Shark Tank landed Ulmer a $60,000 deal with investor Daymond John. Now, after ten years of business, her flaxseed lemonade company has grown into a national brand with products sold in 1,500 stores, including Whole Foods, Wegmans, and The Fresh Market.

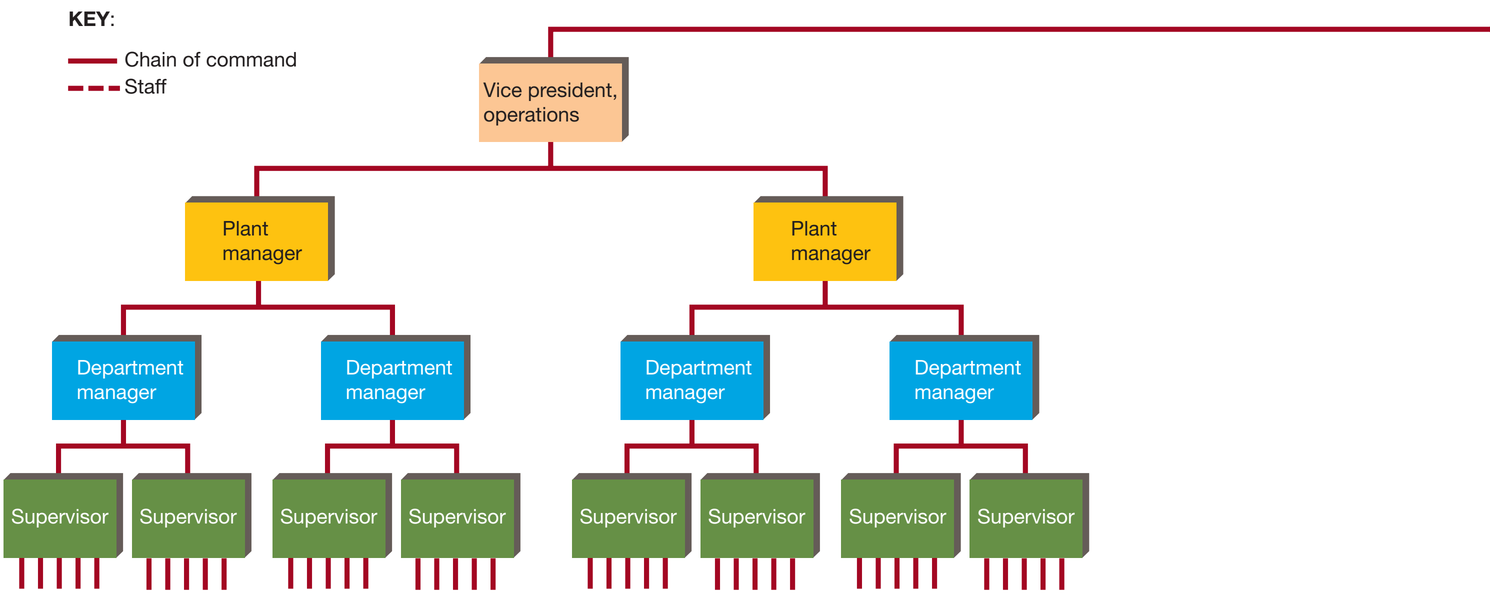
Me & the Bees Lemonade's growth from a lemonade stand to a national brand required numerous organizational changes. In the company's early days, Ulmer hand-pressed lemonade in her kitchen and learned business basics from her dad. As her company grew, Ulmer hired individuals to handle day-to-day business tasks, such as accounting and distribution, while Ulmer attends school, manages the team, travels for speaking engagements, and focuses on the overall business strategy. She believes that finding the right people for your business and seeking out guidance is critical for success.

One day, Ulmer—who was named one of *Time* magazine's 30 most influential teens in America—would like to become an investor herself. Me & the Bees Lemonade expanded its product mix to include lip balm made with beeswax and is continuing to establish new partnerships with major grocery stores. One thing is certain: this social entrepreneur is just getting started.

Sources: Based on information in Me & the Bees, "Meet Mikaila CEO Me & the Bees Lemonade FB #shemeansbusiness," YouTube, April 19, 2018, www.youtube.com/watch?v=-ky89bM-2O4; "Me & the Bees Lemonade: Teen Entrepreneur Shares Inspiring Story," *Today,* November 30, 2020, www.today.com/video/me-the-bees-lemonade-teen-entrepreneur-shares-inspiring-story-96858693857; AJ Horch, "Me & the Bees Lemonade Founder Started Her Empire at 4 Years Old. Her Motto: 'Dream Like a Kid'," *CNBC,* February 26, 2020, www.cnbc.com/2020/02/26/me-the-bees-lemonade-founder-is-expanding-her-biz.html; Addie Broyles, "Balancing Keynotes and Homework: A Day in the Life of the 15-Year-Old Me and the Bees Founder," *Austin American-Statesman,* December 13, 2019, www.statesman.com/foodanddining/20191213/balancing-keynotes-and-homework-day-in-life-of-15-year-old-me-and-bees-founder.

Figure 7-1 A Typical Corporate Organization Chart

A company's organization chart depicts the positions and relationships within the organization and shows the managerial chains of command.


KEY:
Chain of command
Staff
Vice president, operations
Plant manager
Plant manager
Department manager
Department manager
Department manager
Department manager
Supervisor
Supervisor
Supervisor
Supervisor
Supervisor
Supervisor
Supervisor
Supervisor

who works for an organization is part of the direct chain of command. In the chart these positions are represented by broken lines, as you can see with the directors of legal services, public affairs, and human resources. Instead, they hold *advisory*, or *staff*, positions. This difference will be examined later in the chapter when we discuss line-and-staff positions.

Most smaller organizations find organization charts useful. They clarify positions and relationships for everyone in the organization, and they help managers to track growth and change in the organizational structure. However, many large organizations, such as ExxonMobil, Kellogg's, and Procter & Gamble (P&G), do not maintain complete, detailed charts. There are two reasons for this. First, it is difficult to chart even a few dozen positions accurately, much less the thousands that characterize larger firms. Second, larger organizations are almost always changing parts of their structure. An organization chart would be outdated before it was completed. Increasingly, technology can help even large and complicated organizations implement up-to-date organization charts.

When a firm is founded, management must decide how to organize the firm. These decisions focus on job design, departmentalization, delegation, span of management, and chain of command. In the next several sections, we discuss major issues associated with these dimensions.

✓ Concept Check

- How do large and small organizations use organization charts differently?
- Identify the major considerations when organizing a business.

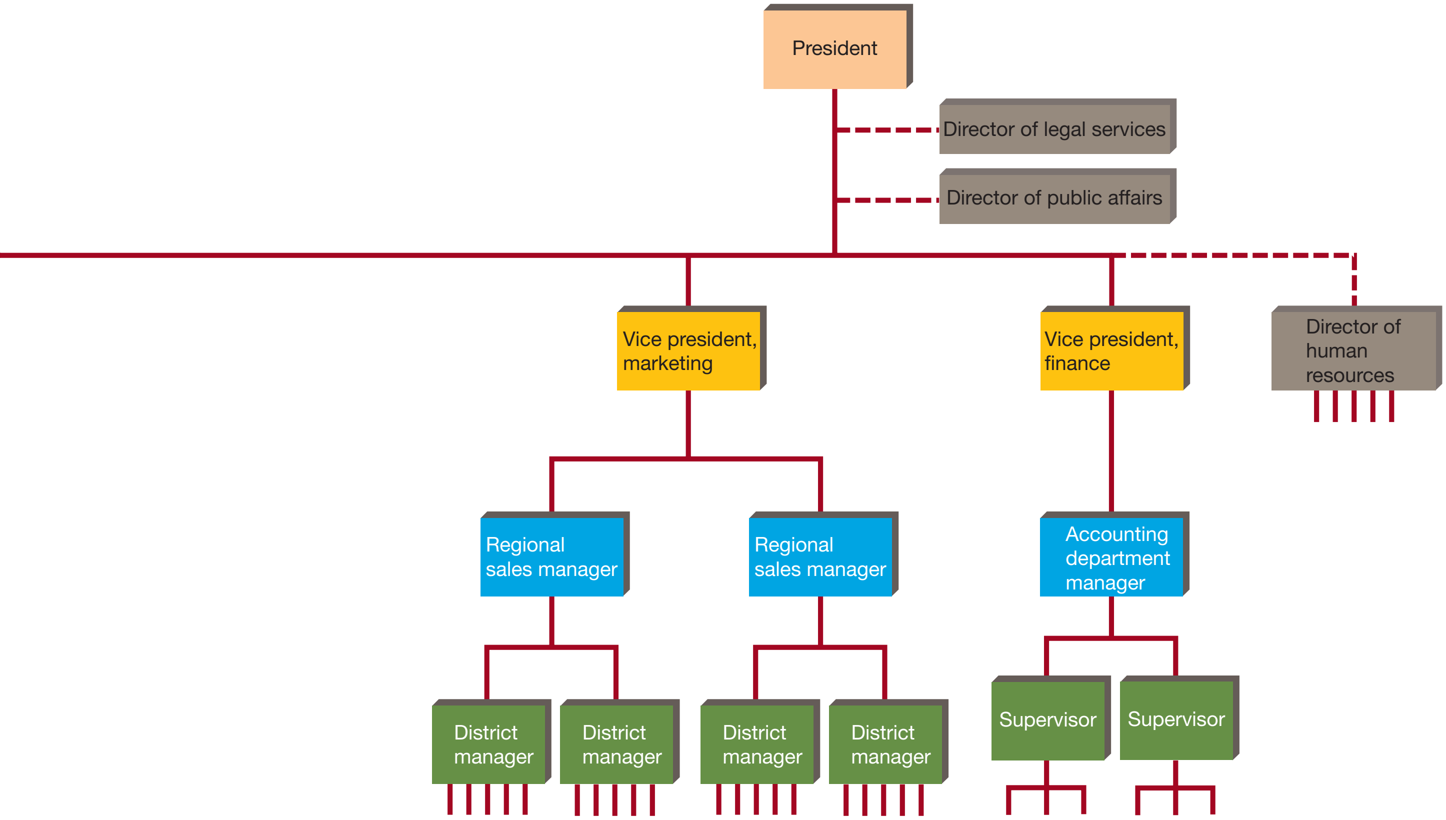
job design structuring the tasks and activities required to accomplish a firm's objectives into specific jobs so as to foster productivity and employee satisfaction

7-2 Job Design

Learning Objective

7-2 Explain why job specialization is important.

The next set of decisions in creating a flexible organization is **job design**, which involves structuring the tasks and activities required to accomplish a firm's objectives into specific jobs so as to foster productivity and employee satisfaction. Job specialization is an often-used approach.


President
Director of legal services
Director of public affairs
Vice president, marketing
Vice president, finance
Director of human resources
Regional sales manager
Regional sales manager
Accounting department manager
District manager
District manager
District manager
District manager
Supervisor
Supervisor

7-2a **Job Specialization**

In Chapter 1, we defined *specialization* as the separation of a manufacturing process into distinct tasks and the assignment of different tasks to different people. Here we are extending that concept to *all* the activities performed within an organization. Thus, **job specialization** is the separation of all organizational activities into distinct tasks and the assignment of different tasks to different people. Adam Smith, the 18th-century economist whose theories gave rise to capitalism, was the first to emphasize the power of specialization in his book, *The Wealth of Nations*. According to Smith, the various tasks in a particular pin factory were arranged so that one worker drew the wire for the pins, another straightened the wire, a third cut it, a fourth ground the point, and a fifth attached the head. Smith claimed that 10 men were able to produce 48,000 pins per day. Before specialization, they could produce only 200 pins per day because each worker had to perform all five tasks!

For a number of reasons, some job specialization is necessary in every organization because the "job" of most organizations is too large for one person to handle. In a firm such as Ford Motor Company, thousands of people are needed to manufacture automobiles. Others are needed to sell the cars, control the firm's finances, and so on. Second, when a worker has to learn one specific, highly specialized task, that individual can learn it quickly and perform it efficiently. Third, a worker repeating the same job does not lose time changing operations, as the pin workers did when producing complete pins. Fourth, the more specialized the job, the easier it is to design specialized equipment. And finally, the more specialized the job, the easier the job training.

Unfortunately, specialization can have negative consequences. The most significant drawback is the boredom and dissatisfaction employees may feel when repeating the same job. Bored employees may be absent from work frequently, not put much effort into their work, and even sabotage the company's efforts to produce quality products.

job specialization the separation of all organizational activities into distinct tasks and the assignment of different tasks to different people

Specialization has its drawbacks. This employee has a specialized job that includes stitching a component of shoes. Specialization is efficient for the firm, but it can leave employees bored and dissatisfied. What do you think a firm can do to offset these problems?

ISTOCK.COM/MIODRAG IGNJATOVIC

7-2b Alternatives to Job Specialization

To combat these problems, managers often turn to job rotation. **Job rotation** is the systematic shifting of employees from one job to another. For example, a worker may be assigned a different job every week for a four-week period and then return to the first job in the fifth week. Job rotation provides a variety of tasks so that workers are less likely to become bored and dissatisfied. Intel, for instance, encourages job rotation as a means of sharing ideas, perspectives, and best practices across the company. Job rotation helps workers stay interested in their jobs, develop new skills, and identify new roles where they may want to focus their energies in the future.

Two other approaches to job design—job enlargement and job enrichment—also can provide solutions to the problems caused by job specialization. These topics, along with other methods used to motivate employees, are discussed in Chapter 10.

✓ Concept Check

- What are the positive and negative effects of specialization?
- What are three ways to reduce the negative effects of specialization?

7-3 Departmentalization

Learning Objective

7-3 Identify the various bases for departmentalization.

After jobs are designed, they must be grouped together into "working units," or departments. This process is called **departmentalization**, which is the process of grouping jobs into manageable units. Today, the most common bases for organizing a business into effective departments are by function, by product, by location, and by customer.

7-3a By Function

Departmentalization by function groups jobs that relate to the same organizational activity. Under this scheme, all marketing personnel are grouped together in the marketing department, all production personnel in the production department, and so on.

Most smaller and newer organizations departmentalize by function. Supervision is simplified because everyone is involved in the same activities and coordination is easy. The disadvantages of this method of grouping jobs are that it can lead to slow decision making and it tends to emphasize the department over the organization as a whole.

job rotation the systematic shifting of employees from one job to another

departmentalization the process of grouping jobs into manageable units

departmentalization by function grouping jobs that relate to the same organizational activity

7-3b **By Product**

Departmentalization by product groups activities related to a particular good or service. P&G, for instance, has divisions for product sectors: baby and feminine care, beauty, fabric and home care, grooming, healthcare and family care, and P&G ventures.[2] This approach is used often by older and larger firms that produce and sell a variety of products. Each department handles its own marketing, production, financial management, and human resources activities.

Departmentalization by product makes decision making easier and provides for the integration of all activities associated with each product. However, it causes some duplication of specialized activities—such as finance—between departments. Moreover, the emphasis is placed on the product rather than on the whole organization.

ISTOCK.COM/ADENE SANCHEZ

How is this firm organized? These call center employees are organized by their function. Some organizations are structured in other ways. For example, if your university has more than one campus, they are organized by location but also by function such as by their business, social sciences, and math departments. Your school also might be organized by customer such as by undergraduate, graduate, and continuing education students.

7-3c **By Location**

Departmentalization by location groups activities according to the defined geographic area in which they are performed. Departmental areas may range from whole countries (for international firms) to regions within countries (for national firms) to areas of several city blocks (for police departments organized into precincts). For example, Ford has divisions for the Americas, Europe, Asia Pacific and Africa, and China. Departmentalization by location allows the organization to respond readily to the unique demands or requirements of different locations. Nevertheless, a large administrative staff and an elaborate control system may be needed to coordinate operations across many locations.

7-3d **By Customer**

Departmentalization by customer groups activities according to the needs of various customer populations. The advantage of this approach is that it allows the firm to deal efficiently with unique customers or customer groups. For example, an aircraft maker might have a department for government customers and one for corporate customers because their needs are different. The biggest drawback is that a larger-than-usual administrative staff is needed.

7-3e **Combinations of Bases**

Many organizations use a combination of departmentalization bases. Toyota, for instance, is reorganizing by product and location. It has product divisions such as R&D and Engineering, Compact Car Company, Mid-size Vehicle Company, CV Company, Lexus International Company, Power Train Company, and Connected Company, as well as divisions based on location.[3]

Take a moment to examine Figure 7-2. Notice that departmentalization by customer is used to organize New-Wave Fashions, Inc., into three major divisions: Men's, Women's, and Children's clothing. Then functional departmentalization is used to distinguish the firm's production and marketing activities. Finally, location is used to organize the firm's marketing efforts.

departmentalization by product grouping activities related to a particular product or service

departmentalization by location grouping activities according to the defined geographic area in which they are performed

departmentalization by customer grouping activities according to the needs of various customer populations

Technology and Innovation

How Apple's Organizational Structure Supports Innovation

Apple's fast-paced, non-stop innovation has greatly contributed to the company's success. This has been enabled by Apple's functional organizational model. When former CEO Steve Jobs returned to the company in 1996, Apple's conventional structure was divided into business units, and each division was run by general managers. However, the decentralized structure often led to conflict among managers and hindered innovation. In a single day, Jobs laid off all the general managers.

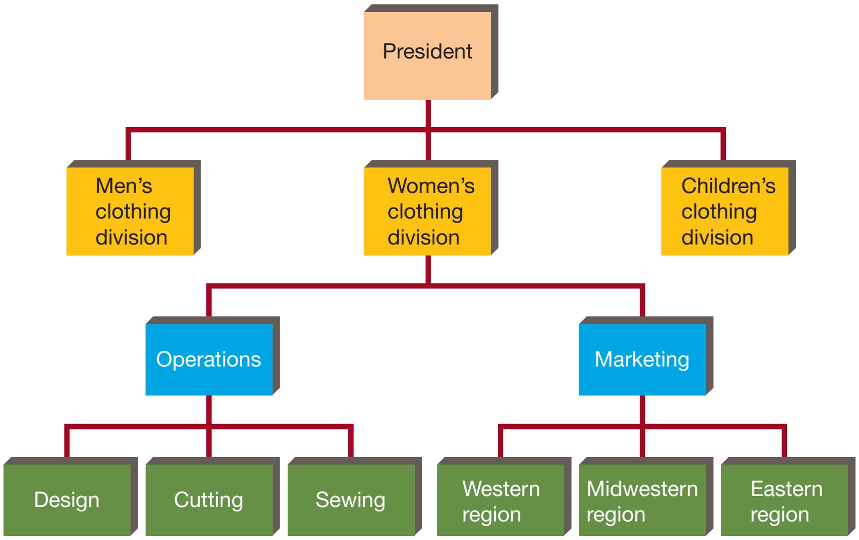
The new structure at Apple combined the functional departments of the business units into one functional organization to align expertise with decision rights. This structure still exists at Apple today even though the company is far more complex than it was in the late 1990s. Aside from Apple's current CEO Tim Cook, the tech giant operates without conventional general managers. Many business experts believe that when firms grow from small start-up to large and complex businesses, they must move from a functional to a multidivisional structure to prevent congestion when it comes to decision making. Apple, however, requires a structure that centers around functional expertise due to its rapid product development and high rates of disruption in the markets in which it competes.

From Apple's point of view, allowing technical experts to make important decisions rather than general managers increases the quality of those decisions and decreases the chances that cost targets will take over the decision-making process. When it comes to introducing a new product or a new feature, Apple is able to strike a balance between cost and the value added to the user experience by aligning expertise with decision rights.

Sources: Based on information in Joel M. Podolny and Morten T. Hansen, "How Apple Is Organized for Innovation," *Harvard Business Review,* November–December 2020, www.hbr.org/2020/11/how-apple-is-organized-for-innovation; Jonny Evans, "The Apple University Guide to Effective Business Management," *Computer World,* October 23, 2020, www.computerworld.com/article/3587136/the-apple-university-guide-to-effective-business-management.html.

Figure 7-2 **Multibase Departmentalization for New-Wave Fashions, Inc.**

Most firms use more than one basis for departmentalization to improve efficiency and to avoid overlapping positions.



✓ Concept Check

- What are the four most common bases for departmentalization?
- Give an example of each.

7-4 Delegation, Decentralization, and Centralization

Learning Objective

7-4 Describe how decentralization follows from delegation.

The third major step in the organizing process is to distribute power in the organization. **Delegation** assigns work and power to other workers. The degree of centralization or decentralization of authority is determined by the overall pattern of delegation within the organization.

7-4a Delegation of Authority

Because no manager can do everything, delegation is vital to completion of a manager's work. Delegation is also important in developing the skills and abilities of subordinates. It allows those who are being groomed for higher-level positions to play increasingly important roles in decision making.

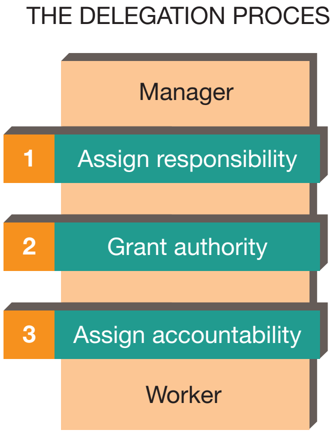
Steps in Delegation The delegation process generally involves three steps (refer to Figure 7-3). First, the manager must *assign responsibility*. **Responsibility** is the duty to do a job or perform a task. In most job settings, a manager simply gives the worker a job to do. Typical job assignments might range from preparing a report on the status of a new quality control program to being put in charge of a task force. Second, the manager must *grant authority*. **Authority** is the power, within the organization, to accomplish an assigned job or task. This might include the power to obtain specific information, order supplies, authorize relevant expenditures, or make certain decisions. Finally, the manager must *create accountability*. **Accountability** is the obligation of a worker to accomplish an assigned job or task.

Note that accountability is created but it cannot be delegated. Suppose that you are an operations manager for Target and are responsible for performing a specific task. You, in turn, delegate this task to someone else. You nonetheless remain accountable to your immediate supervisor for getting the task done properly. If the other person fails to complete the assignment, you—not the person to whom you delegated the task—will be held accountable.

Barriers to Delegation For several reasons, managers may be unwilling to delegate work. This may be because the manager does not trust the employee to complete the task, or because the manager fears the employee will perform exceptionally and attract the notice of higher-level managers. Finally, some managers do not delegate because they are disorganized and they are not able to plan and assign work effectively.

Figure 7-3 Steps in the Delegation Process

To be successful, a manager must learn how to delegate. No one can do everything alone.



delegation assigning part of a manager's work and power to other workers

responsibility the duty to do a job or perform a task

authority the power, within an organization, to accomplish an assigned job or task

accountability the obligation of a worker to accomplish an assigned job or task

Ethics and Social Responsibility

Top Managers Feel Pressure to Bend the Rules

Occasionally, employees may feel pressure to compromise on their organization's ethics standards, which can contribute to a decline in the company's overall reputation and performance. According to the Ethics & Compliance Initiative's Global Business Ethics Survey, top managers are twice as likely to experience this type of pressure. Pressure to bend the rules can be caused by factors such as meeting performance goals, trying to save one's job, or attempting to advance one's career or financial interests.

The survey shows that employees higher up in the organizational chart are most at risk for feeling pressure to bend the rules in the workplace. The survey also revealed that when top management shows a strong commitment to both ethical leadership and organizational values, the employees they oversee are three times less likely to experience pressure. Leaders need to understand the importance of their role in managing employees and should be trained on the skills necessary to demonstrate support for organizational ethics and values to subordinates.

Understanding risk factors can help organizations be proactive in addressing potential conflicts before they arise. To reduce workplace pressures, firms can commit to ethical leadership and shared values while building an ethics-focused organizational culture. Building a strong ethics and compliance program that holds employees accountable for their mistakes can be critical in maintaining strong ethics health.

Sources: Based on information in "Global Business Ethics Survey: Top Managers Twice as Likely to Experience Pressure to Bend the Rules in Organizations," *Yahoo Finance,* August 31, 2020, finance.yahoo.com/news/global-business-ethics-survey-top-150000884.html; Ethics and Compliance Initiative, "Global Business Ethics Survey: Pressure in the Workplace," 2020, www.ethics.org/wp-content/uploads/Global-Business-Ethics-Survey-2020-Report-1-Final.pdf; Jaclyn Jaeger, "Survey: Weak Leadership Contributes to Employee Pressure to Bend Rules," *Compliance Week,* August 21, 2020, www.complianceweek.com/ethics-and-culture/survey-weak-leadership-contributes-to-employee-pressure-to-bend-rules/29346.article.

decentralized organization an organization in which management consciously attempts to spread authority widely across various organization levels

7-4b Decentralization of Authority

The pattern of delegation throughout an organization determines the extent to which that organization is decentralized or centralized. In a **decentralized organization**, management consciously attempts to spread authority widely across various organization levels. A **centralized organization**, on the other hand, systematically works to concentrate authority at the upper levels. For example, shipping companies like UPS tend to be centralized, with shipping dispatches coordinated by upper management. Large organizations may have characteristics of both decentralized and centralized organizations. Berkshire Hathaway is a highly decentralized conglomerate corporation that owns more than 80 companies. Though the CEOs of each subsidiary company report directly to Berkshire Hathaway's CEO Warren Buffett, they are trusted, given nearly complete autonomy, and encouraged to plan for the long term as long as they do so in accordance with Berkshire Hathaway's ethical code. Such strict decentralization is unusual, particularly in such a huge parent company, but it helped Warren Buffett, the founder, build a $500 billion company.[4]

ISTOCK.COM/FIZKES

Delegate, delegate, delegate. The industrialist Andrew Carnegie once said, "No person will make a great business who wants to do it all himself or get all the credit." Delegating gives employees different tasks to do, which can enrich and enlarge their jobs. It also enables both employees and their superiors to learn new skills required for higher-level positions.

A number of factors can influence the extent to which a firm is decentralized. One is the external environment in which the firm operates. The more complex and unpredictable this environment, the more likely it is that top management will let lower-level managers make important decisions because lower-level managers are closer to the issues and the customers. Another factor is the nature of the decision itself. The riskier or more important the decisions that have to be made, the greater is the tendency to centralize decision making. A third factor is the abilities of lower-level managers. If these managers do not have strong decision-making skills, top managers will be reluctant to decentralize. Finally, a firm that has practiced centralization or decentralization is likely to maintain that same posture in the future.

In principle, neither decentralization nor centralization is right. What works for one organization may or may not work for another. Every organization must assess its own situation and choose the level of centralization or decentralization that will work best.

✓ Concept Check

- Identify and describe the three steps in the delegation process.
- Differentiate decentralized organization and centralized organization.

7-5 The Span of Management

Learning Objective

7-5 Explore how the span of management describes an organization.

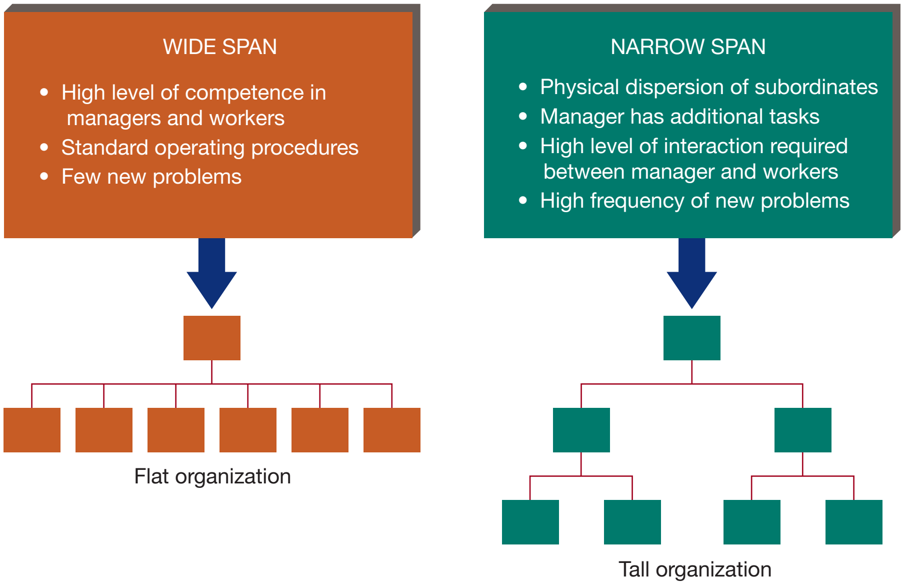
The fourth major step in organizing a business is establishing the **span of management** (or **span of control**), which is the number of workers who report directly to one manager. Hundreds of years of research has shown that there is no perfect ratio of subordinates to managers. More recently, theorists have focused on the width of the span of management. This issue is complicated because the span of management may change by department within the same organization. A highly mechanized factory where all operations are standardized may allow for a wide span of management. An advertising agency, where new problems and opportunities arise every day and where teamwork is a constant necessity, will have a much narrower span of management.

7-5a Wide and Narrow Spans of Management

A *wide* span of management exists when a manager has a larger number of subordinates. A *narrow* span exists when the manager has only a few subordinates. Several factors determine the span that is best for a particular manager (refer to Figure 7-4). Generally, the span of management may be wide

Figure 7-4 The Span of Management

Several criteria determine whether a firm uses a wide span of management, in which a number of workers report to one manager, or a narrow span, in which a manager supervises only a few workers.


WIDE SPAN
• High level of competence in managers and workers
• Standard operating procedures
• Few new problems
Flat organization
NARROW SPAN
• Physical dispersion of subordinates
• Manager has additional tasks
• High level of interaction required between manager and workers
• High frequency of new problems
Tall organization

centralized organization an organization that systematically works to concentrate authority at the upper levels of the organization

span of management (or **span of control**) the number of workers who report directly to one manager

ISTOCK.COM/CECILIE_ARCURS

Narrow versus wide spans of management: Which is better? The manager in the middle of the photo supervises only a handful of employees. Consequently, she has a narrow span of management. Companies are constantly searching for the ideal number of employees their supervisors should manage.

when (1) the manager and the subordinates are very competent, (2) the organization has a well-established set of standard operating procedures, and (3) few new problems are expected to arise. The span should be narrow when (1) workers are physically located far from one another, (2) the manager has much work to do in addition to supervising workers, (3) a great deal of interaction is required between supervisor and workers, and (4) new problems arise frequently.

7-5b Organizational Height

The span of management has an obvious impact on relations between managers and workers. It has a more subtle, but equally important, impact on the height of the organization. **Organizational height** is the number of layers, or levels, of management in a firm. The span of management plays a direct role in determining the height of the organization (refer to Figure 7-4). If the span of management is wide, fewer levels are needed, and the organization is *flat*. If the span of management is narrow, more levels are needed, and the resulting organization is *tall*.

In a tall organization, administrative costs are higher because more managers are needed. Communication may become distorted because information has to pass up and down through more levels. When companies are cutting costs, one option is to decrease organizational height in order to reduce related administrative expenses. For example, Infosys, an India-based information technology firm, flattened its five-tiered structure into two layers in order to speed up decision making, achieve greater flexibility, eliminate redundancies among management positions, and reduce costs.[5] Although flat organizations avoid these problems, their managers may perform more administrative duties simply because there are fewer managers. Wide spans of management also may require managers to spend considerably more time supervising and working with subordinates.

✓ Concept Check

- Describe the two spans of management.
- What are problems associated with each one?

7-6 Forms of Organizational Structure

Learning Objective

7-6 Identify four forms of organizational structure.

Up to this point, we have focused our attention on the major characteristics of organizational structure. In many ways, this is like discussing the parts of a jigsaw puzzle one by one. It is now time to put the puzzle together. We will next discuss four basic forms of organizational structure: line, line-and-staff, matrix, and virtual.

7-6a The Line Structure

The simplest and oldest form of organizational structure is the **line structure**, in which the chain of command goes directly from person to person throughout the organization. Thus, a straight line could be drawn down through the levels of management, from the chief executive down to the lowest level in the organization. In a small retail store, for example, an hourly employee might report to an assistant manager, who reports to a store manager, who reports to the owner.

organizational height the number of layers, or levels, of management in a firm

line structure an organizational structure in which the chain of command goes directly from person to person throughout the organization

Managers within a line structure, called **line managers**, make decisions and give orders to subordinates to achieve the organization's goals. A line structure's simplicity and clear chain of command allow line managers to make decisions quickly with direct accountability because the decision maker only has one supervisor to report to.

The downside of a line structure is that line managers are responsible for many activities, and therefore must have a wide range of knowledge about all of them. While this may not be a problem for small organizations with a lower volume of activities, in a larger organization, activities are more numerous and complex, thus making it more difficult for line managers to fully understand what they oversee. Therefore, line managers in a larger organization would have a hard time making an educated decision without expert advice from outside sources. As a result, line structures are not very effective in medium- or large-sized organizations, but are very popular in small organizations.

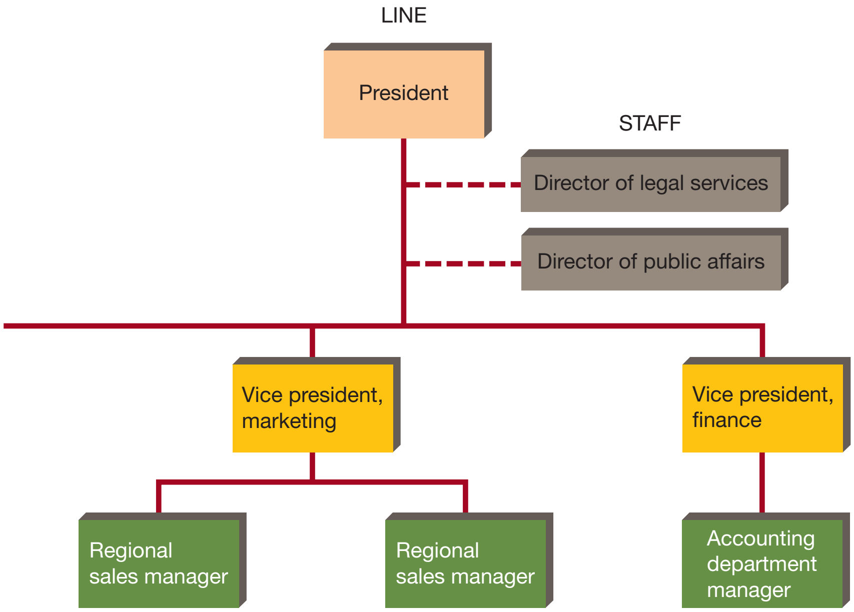
7-6b The Line-and-Staff Structure

A **line-and-staff structure** not only utilizes the chain of command from a line structure but also provides line managers with specialists, called staff managers. Therefore, this structure works much better for medium- and large-sized organizations than line management alone. **Staff managers** provide support, advice, and expertise to line managers, thus eliminating the major drawback of line structures. Staff managers are not part of the chain of command like line managers are, but they do have authority over their assistants (refer to Figure 7-5).

Both line and staff managers are needed for effective management, but the two positions differ in important ways. Most importantly, line managers have *line authority*, which means that they can make decisions and issue directives relating to the organization's goals. Staff managers seldom have this kind of authority. Instead, they usually have either advisory authority or functional authority. *Advisory authority* is the expectation that line managers will consult the appropriate staff manager when making decisions. *Functional authority* is a

Figure 7-5 Line and Staff Managers

A line manager has direct responsibility for achieving the company's goals and is in the direct chain of command. A staff manager supports and advises the line managers.


LINE
President
STAFF
Director of legal services
Director of public affairs
Vice president, marketing
Vice president, finance
Regional sales manager
Regional sales manager
Accounting department manager

line managers managers who make decisions and give orders to subordinates to achieve the organization's goals

line-and-staff structure an organizational structure that utilizes the chain of command from a line structure in combination with the assistance of staff managers

staff managers managers who provide support, advice, and expertise to line managers stronger form. It is the authority of staff managers to make decisions and issue directives about their areas of expertise. For example, a legal adviser for Nike can decide whether to retain a particular clause in a contract but cannot decide product pricing.

Staff managers in a line-and-staff structure tend to have more access to information than line managers. This means that line managers must rely on the staff managers for information. This is usually not an issue, unless staff managers make a wrong decision and there is no one else to catch their mistake.[6] For a variety of reasons, conflict between line managers and staff managers is fairly common in business. Staff managers often have more formal education and sometimes are younger (and perhaps more ambitious) than line managers. Line managers may perceive staff managers as a threat to their own authority and thus may resent them. For their part, staff managers may become annoyed or angry if their expert recommendations are not adopted by line management.

Fortunately, there are several ways to minimize the likelihood of such conflict. One way is to integrate line and staff managers into one team. Another is to ensure that the areas of responsibility of line and staff managers are clearly defined. Finally, line and staff managers both can be held accountable for the results of their activities.

ANDREAS RENTZ/GETTY IMAGES ENTERTAINMENT/GETTY IMAGES

Line-and-staff organization structure. Ronald McDonald occupies a staff position and does not have direct authority over other employees at McDonald's. Holger Beeck, the CEO of McDonald's Germany, does have direct authority over other McDonald's employees and thus occupies a line position.

7-6c The Matrix Structure

The **matrix structure** combines vertical and horizontal lines of authority, forming a matrix shape in the organizational chart. The matrix structure occurs when product departmentalization is superimposed on a functionally departmentalized organization. In a matrix organization, authority flows both down and across, and individuals report to more than one superior at the same time.

To understand the structure of a matrix organization, consider the usual functional arrangement, with people working in departments such as engineering, finance, and marketing. Now suppose that we assign people from these departments to a special group that is working on a new project as a team—a cross-functional team. A **cross-functional team** consists of individuals with varying specialties, expertise, and skills who are brought together to achieve a common task. Frequently, cross-functional teams are charged with the responsibility of developing new products. The manager in charge of a team is usually called a *project manager*. Any individual who is working with the team reports to *both* the project manager and the individual's superior in the functional department (refer to Figure 7-6).

Matrix structures offer advantages over other organizational forms, added flexibility probably being the most obvious one. The matrix structure can also increase productivity, raise morale, and nurture creativity and innovation. In addition, employees experience personal development through doing a variety of jobs.

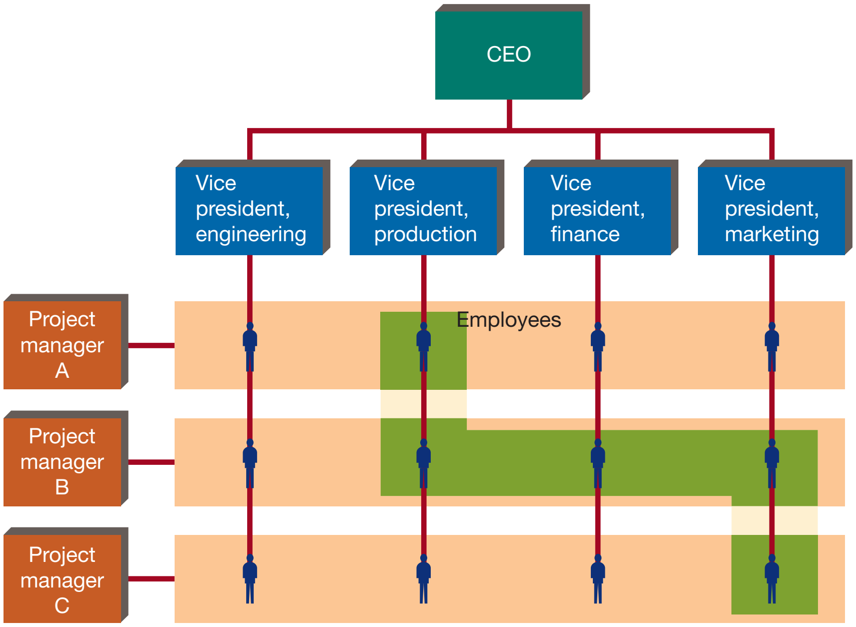
The matrix structure also has disadvantages. Having employees report to more than one supervisor can cause confusion about who is in charge. Like committees, teams may take longer to resolve problems and issues than individuals working alone. Other difficulties include personality clashes, poor communication, undefined individual roles, unclear responsibilities, and difficulties in finding ways to reward individual and team performance simultaneously. Because more managers and support staff may be needed, a matrix structure may be more expensive to maintain.

matrix structure an organizational structure that combines vertical and horizontal lines of authority, usually by superimposing product departmentalization on a functionally departmentalized organization

cross-functional team a team of individuals with varying specialties, expertise, and skills who are brought together to achieve a common task

Figure 7-6 A Matrix Structure

A matrix is usually the result of combining product departmentalization with function departmentalization. It is a complex structure in which employees have more than one supervisor.



Source: Ricky W. Griffin, *Fundamentals of Management*, 9th ed. Copyright © 2019, p. 157 by Cengage, Boston, MA. Adapted with permission.

7-6d The Virtual Structure

ISTOCK.COM/BLUE PLANET STUDIO

In a **virtual structure** (sometimes called a *network organization*), administration is the primary function performed, and other functions such as engineering, production, marketing, and finance are contracted out to other organizations. Such structures may be temporary, such as a group of individuals and companies collaborating to develop and distribute a feature film. Organizational members often operate in different locations, and they communicate and share work via video and software tools. Frequently, a virtual organization does not manufacture the products it sells. This type of organization has a few permanent employees consisting of top management and hourly clerical workers. Leased facilities and equipment, as well as temporary workers, are increased or decreased as the organization's needs change. Thus, there is limited formal structure associated with a virtual organization.

An obvious strength of a virtual structure is flexibility that allows the organization to adjust quickly to changes. Virtual structures consist of a lot of teams working together, rather than relying on one centralized leader. One noteworthy benefit is that firms with a virtual structure are more likely to survive the loss of an important member. Some of the challenges faced by managers in network-structured organizations include controlling the quality of work performed by other organizations, low morale and high turnover among hourly workers, and a lack of a clear hierarchy.

virtual structure an organizational structure in which administration is the primary function, and most other functions are contracted out to other firms

✓ Concept Check

- Describe four forms of organizational structure.
- Give an example of each form.

7-7 Teams and Teamwork

Learning Objective

7-7 Examine the types, development, and uses of teams.

The concepts of teams and teamwork may be most commonly associated with sports, but they are also integral parts of business organizations. The use of teams is popular because it encourages employees to participate more fully in business decisions. The growing number of companies organizing their workforces into teams reflects an effort to increase employee productivity and creativity because team members are working on specific goals and are given greater autonomy. This leads to greater job satisfaction as employees feel more involved in the management process.[7]

7-7a What Is a Team?

In a business organization, a **team** is two or more workers collaborating to achieve a shared mission, goal, or work product. In particular, team members share responsibility and accountability, and their performance is measured by their collective effort. A team may be assigned any number of tasks or goals, from development of a new product to selling that product. A team can also be created to identify or solve a problem that an organization is experiencing. Teamwork may seem like a simple concept, but teams are a microcosm of the organization, and any complications in the work environment will affect the team.

7-7b Types of Teams

Businesses may have several types of teams to achieve different purposes, including problem-solving teams, self-managed teams, cross-functional teams, and virtual teams. Regardless of type, all team members must collaborate to bring their respective skills, knowledge, and resources to fulfill the team's shared purpose.

Problem-Solving Teams The most common type of team in business organizations is the **problem-solving team**. It is generally used temporarily to bring knowledgeable employees together to tackle a specific problem. Once the problem is solved, the team typically is disbanded.

Self-Managed Work Teams **Self-managed teams** are groups of employees with the authority and skills to manage themselves. Experts suggest that workers on self-managed teams are more motivated and satisfied because they have greater task variety and job control. On many work teams, members are cross trained to perform everyone else's jobs and rotate through all the jobs for which the team is responsible. In a traditional business structure, management is responsible for hiring and firing employees, establishing budgets, purchasing supplies, conducting performance reviews, and taking corrective action. When self-managed teams are in place, they take over some or all of these management functions. The major advantages and disadvantages of self-managed teams are detailed in Figure 7-7.

Figure 7-7 **Advantages and Disadvantages of Self-Managed Teams**

While self-managed teams provide advantages, managers must recognize their disadvantages.

ADVANTAGES	DISADVANTAGES
• Boosts employee morale	• Additional training costs
• Increases productivity	• Teams may be disorganized
• Aids innovation	• Conflicts may arise
• Reduces employee boredom	• Leadership role may be unclear

team two or more workers collaborating to achieve a shared mission, goal, or work product

problem-solving team a team of knowledgeable employees brought together to tackle a specific problem

self-managed teams groups of employees with the authority and skills to manage themselves

Cross-Functional Teams Earlier, we discussed how matrix structures often rely on cross-functional teams of individuals with varying specialties, expertise, and skills that are brought together to achieve a common task. For example, a purchasing agent might create a cross-functional team to gain insight into useful purchases for the company. Ideally, a cross-functional team consists of a group of people with complementary skill sets and perspectives to enable the group to solve problems effectively and efficiently. Cross-functional team projects may be temporary, in which case the team is disbanded once the mission is accomplished, or they may be permanent.

These teams often are empowered to make major decisions. When a cross-functional team is employed, prospective team members may receive special training because effective teamwork can require different skills. For cross-functional teams to be successful, team members must be given specific information on the job each performs. The team must also develop a sense of cohesiveness and maintain good communications among its members.

Although cross-functional teams are not necessarily self-managed, most self-managed teams are cross-functional. Cross-functional teams can also be cross-divisional. The internet and digital tools have helped strengthen the communication abilities of cross-functional teams. Increasingly, the ability to work in cross-functional teams is an important skill as the world becomes more interconnected and businesses must adapt quickly to change. Major corporations such as Google, Whirlpool, and Procter & Gamble all utilize the diverse viewpoints that come out of cross-functional teams.

Virtual Teams Teams no longer have to be geographically close, thanks to sophisticated communications technology. A **virtual team** consists of members who are geographically dispersed but communicate electronically. In fact, team members may never meet in person but rely solely on email, video conferences, voice mail, and other technological interactions. Increasingly, virtual teams rely on group collaboration services such as Slack and Teams that serve as virtual offices where employees can gather to chat and share files and information. They are also likely to use video meeting services such as Skype, Webex, or GoToMeeting to have real-time direct visual interactions. In the global business environment, virtual, or remote, teams connect employees located anywhere in the world on a common task. Indeed, some virtual team members may be outside the firm, such as contract employees, freelancers, consultants, or employees from other organizations that are involved in the team's project. However, distance, time differences, and the lack of spontaneous face time can make working on virtual teams challenging. Clear communication is essential, especially among team members who have never met in person. Email, text, and chat communications, for example, can be misinterpreted. Team members need to be respectful of cultural and language differences in order to focus on the process and results.

ISTOCK.COM/POPBA

Using technology to close time and space and get more done. Skype, email, and group chat software are allowing employees continents away from one another to work together effectively. Being able to hire the best employees from all around the globe to work virtually with one another can give a firm a competitive advantage. Virtual teams located in different time zones and on different continents can also enable a company to work on important projects 24/7.

7-7c Developing and Using Effective Teams

It takes time for team members to establish individual roles, relationships, and duties in order to become an effective team. As a team matures, it passes through five stages of development, as shown in Figure 7-8.

virtual team a team consisting of members who are geographically dispersed but communicate electronically

Exploring Careers

Preparing for a Virtual Career

Thanks to advancements in technology, people can work from almost anywhere. The work-from-home trend was greatly accelerated by the COVID-19 pandemic, and it's likely to continue in the long term. As companies rely more and more on virtual teams, it's critical to prepare for the future of remote work by addressing key challenges: communication, isolation, and a lack of social opportunities.

One of the top challenges of remote work is clear communication. Relying solely on e-mail, webchat, and video conferences reduces opportunities for reading body language and asking follow up questions, which can result in things getting lost in translation. To counteract this, more frequent, higher quality, proactive communication is in order along with comprehensive documentation of virtual team discussions and tasks assigned to each individual.

To combat isolation, employees can more intentionally engage in video chat. Opting for voice-only contact allows for distraction. It can be tempting to multitask when the camera is disabled, checking smartphone notifications or perusing emails. Video conference is a good substitution for traditional face-to-face meetings and allows for better engagement than emails and phone calls alone. As Microsoft CEO Satya Nadella says, "Digital technology should not be a substitute for human connection." The social element of a traditional office job is difficult to replicate online. Carve out time in team meetings to socialize or schedule dedicated meetings to connect with teammates.

Remote work is on the rise, and it's here to stay. While working virtually offers many benefits, there are also challenges that must be addressed. Preparing properly for the remote work environment can increase productivity, improve communication, and contribute to overall happiness.

Sources: Based on information in John Seabrook, "Has the Pandemic Transformed the Office Forever?" *The New Yorker,* January 25, 2021, https://www.newyorker.com/magazine/2021/02/01/has-the-pandemic-transformed-the-office-forever; Jolene Risch, "5 Keys to Having a Remote Staff That's Engaged," *Entrepreneur,* January 25, 2021, www.entrepreneur.com/article/362642; Marie Prokopets, "10 Practices That Will Ensure You Succeed at Remote Work," *We Work Remotely,* August 13, 2019, www.weworkremotely.com/10-practices-that-will-ensure-you-succeed-at-remote-work.

Forming In the *forming* stage, team members are introduced to one another and begin to develop a social dynamic. The members of the team are unsure about how to relate to one another, what behaviors are acceptable, and what the ground rules are for the team. Through group member interaction over time, team members become more comfortable and a group dynamic emerges.

Storming During the *storming* stage, the interaction may be volatile, and the team may lack unity. This is the stage at which goals and objectives begin to develop. Team members will brainstorm to develop ideas and plans and establish a broad-ranging agenda. It is important for team members to grow comfortable with each other so that they can contribute openly. It is unlikely that a team leader has materialized by this stage, although an informal leader may emerge. The success or failure of the ideas in the storming stage determines how long the team will take to reach the next stage.

Norming After storming and the first burst of activity, the team begins to stabilize during the *norming* stage. Each person's role within the group begins to solidify, and members recognize the roles of others. A sense of unity grows during this stage. If it has not occurred already, an identified leader will emerge. The group may remain somewhat in flux during norming and may even regress back to the storming stage if any conflict, especially over the leadership role, occurs.

Performing The fourth stage, *performing*, is when the team achieves its full potential, finally focusing on the assigned task. This stage may take a long time to develop, as team development issues can be complicated. The members of the team finally work in harmony under the established roles to accomplish the necessary goals.

Adjourning In the final stage, *adjourning*, the team is disbanded because the project is complete. Team members may be reassigned to other teams or tasks. This stage will not occur if the team is placed together for a task with no specific date of completion. For example, a marketing team may continue to develop promotional efforts for a store even after a specific promotional task has been accomplished.

7-7d Roles within a Team

Within any team, each member has a role to play in helping the team attain its objectives. Each of these roles adds important dimensions to team member interactions. The group member who pushes the team toward achieving goals and objectives plays the *task-specialist role* by concentrating fully on the assigned task. In a cross-functional team, this might be the person with the most expertise relating to the current task. The *socioemotional* role is played by the individual who supports and encourages the emotional needs of the other members, placing the team members' personal needs above the task at hand. Although this may sound like an unimportant role, the socioemotional member's dedication to team cohesiveness leads to greater unity and higher productivity. Some team members play a *dual role*, which is a combination of the socioemotional and task-specialist roles. Team leaders might not always play this dual role, but the team is likely to be most successful when they do. Sometimes an individual assumes the *nonparticipant role*. This role behavior is characterized by people who do not contribute to accomplishing the task and do not provide favorable input with respect to team members' socioemotional needs. They are obviously not desirable team members to have.

7-7e Team Cohesiveness

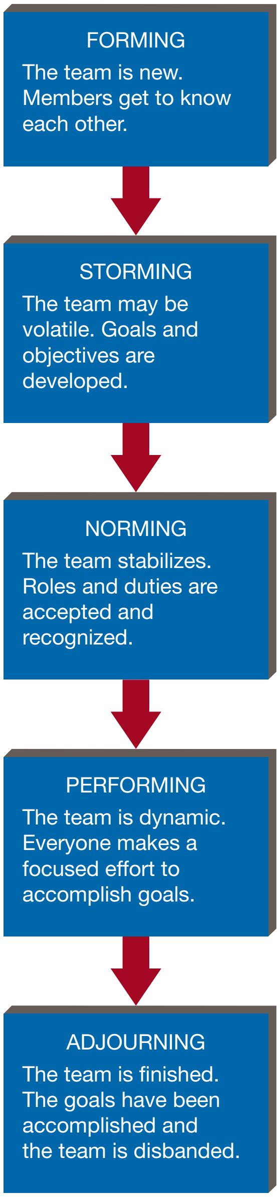
Developing a unit from a diverse group of personalities, specialties, backgrounds, and work styles can be challenging and complicated. In a cohesive team, the members get along and are able to accomplish their tasks effectively. Team cohesiveness is affected by different factors, internal and external to the team. To assure cohesiveness, the ideal team size is generally 5 to 12. Anything larger and relationship development becomes too complicated. Anything smaller and the group may be excessively burdened, and tasks may not get completed. Jeff Bezos, founder and executive chairman of Amazon, famously believes that a team is too large if it takes more than two pizzas to feed everyone on it.[8] One of the most reliable ways to build cohesiveness within a team is through competition with other teams. When two teams are competing for a single prize or recognition, they are forced to become more goal-oriented and to put aside conflict. A favorable appraisal from an outsider may strengthen team cohesiveness. Because the team is being praised as a group, team members recognize their contribution as a unit. Teams are also more successful when goals have been agreed upon beforehand. A team that is clear about its objective will be able to focus on accomplishing it. Frequent interaction also builds team cohesiveness through increasing familiarity.

7-7f Team Conflict and How to Resolve It

Conflict occurs when a disagreement arises between two or more team members. Conflict traditionally has been viewed as negative, but it is unavoidable.

Figure 7-8 Stages of Team Development

When attempting to develop teams, managers must understand that multiple stages are generally required.


FORMING
The team is new. Members get to know each other.
STORMING
The team may be volatile. Goals and objectives are developed.
NORMING
The team stabilizes. Roles and duties are accepted and recognized.
PERFORMING
The team is dynamic. Everyone makes a focused effort to accomplish goals.
ADJOURNING
The team is finished. The goals have been accomplished and the team is disbanded.

ISTOCK.COM/SDI PRODUCTIONS

Go team, go! More companies today are using team-building exercises to help their employees figure out how to work better with one another.

If handled properly conflict can improve a team. For example, if two team members disagree about a proposition, both will spend extra time analyzing the situation closely to determine the best decision. As long as conflict is handled in a respectful and professional manner, it can improve the quality of work produced. However, if conflict turns hostile and affects the work environment, then steps must be taken to arrive at a compromise. Compromises can be difficult because neither party ends up getting everything they want. The best solution is a middle-ground alternative in which each party is satisfied to some degree. Conflict must be acknowledged before it can be dealt with or used in a constructive manner. Ignoring conflict may cause it to simmer or grow, disrupting team progress.

7-7g **Benefits and Limitations of Teams**

Understanding how teams evolve, become cohesive, and resolve conflict can help managers maximize the benefits of teams. Cohesive teams comprised of individuals with diverse skills and perspectives can achieve great creativity and innovation. They can also improve quality and response time. Teamwork can be key to reducing turnover and costs and increasing productivity, customer service, and product quality. There is also evidence that working in teams leads to higher levels of job satisfaction among employees and a harmonious work environment. Thus, an increasingly large number of companies use teams as a valuable element of their organizational structures.

However, the process of organizing teams can be stressful and time consuming, and there is no guarantee that a team will develop effectively. Obviously, teams require individuals to give up some independence in order to achieve goals, and they may have to share credit for ideas they develop within the team—even if they did most of the work. Teams can be frustrated by the unwillingness of one member to work toward team goals. If a team lacks cohesiveness and is unable to resolve conflicts, the company may experience lower productivity.

✓ Concept Check

- What are the major types of teams?
- Highlight some differences between cross-functional teams and virtual teams.
- Identify and describe the stages of team development.
- How can team conflict be reduced?
- What are some of the benefits and limitations of a team?

7-8 Committees and Task Forces

Learning Objective

7-8 Describe how committees and task forces are used.

In addition to teams, organizations today use several types of formal committees that may affect structure. These formal groups are typically brought together to represent members of the larger organization. An **ad hoc committee** is created for a specific short-term purpose, such as reviewing the firm's employee benefits plan or updating its diversity initiatives. Once its work is finished, the ad hoc committee disbands. A **standing committee** is a relatively permanent committee charged with performing a recurring task. A firm might establish a budget review committee, for example, to review departmental budget requests on an ongoing basis. Finally, a **task force** is a committee established to investigate a major problem or pending decision. A firm contemplating a merger with another company might form a task force to assess the pros and cons of the merger.

Committees offer some advantages over individual action. Their several members are able to bring information and knowledge to the task at hand. Furthermore, committees tend to make more accurate decisions and to transmit their results through the organization more effectively. However, committee deliberations take

ad hoc committee a committee created for a specific short-term purpose

standing committee a relatively permanent committee charged with performing some recurring task

task force a committee established to investigate a major problem or pending decision longer than individual actions. In addition, unnecessary compromise may take place within the committee, or the opposite may occur, as one person dominates (and thus negates) the committee process.

✓ Concept Check

- What is the difference between a committee and a task force?
- What are the advantages and disadvantages of using committees?

7-9 The Informal Organization and the Grapevine

Learning Objective

7-9 Explain the functions of the informal organization and the grapevine in a business.

So far, we have discussed the organization as a formal structure consisting of interrelated positions. This is the organization that is shown on an organization chart. There is another kind of organization, however, that does not appear on any chart. We define this **informal organization** as the pattern of behavior and interaction that stems from personal rather than official relationships. Embedded within every informal organization are informal groups and the notorious grapevine.

An **informal group** is created by the group members themselves to accomplish goals that may or may not be relevant to the organization. Workers may create an informal group to go bowling, form a union, get a particular manager fired or transferred, or meet for lunch. The group may last for several years or a few hours.

Informal groups can be powerful forces in organizations. They can restrict output, or they can help managers through tight spots. They can cause disagreement and conflict, or they can help to boost morale and job satisfaction. They have the power to improve or worsen employee performance and productivity. Clearly, managers should be aware of informal groups and determine how to utilize them.

The **grapevine** is the informal communications network within an organization. It is completely separate from—and sometimes much faster than—the organization's formal channels of communication. Formal communications usually follow a path that parallels the organizational chain of command. Information can be transmitted through the grapevine in any direction—up, down, diagonally, or horizontally across the organizational structure. Subordinates may pass information to their bosses, an executive may relay something to a maintenance worker, or there may be an exchange of information between people who work in totally unrelated departments. Information gleaned from the grapevine can run the gamut from the latest management decisions to gossip.

ISTOCK.COM/ND3000

There is power in numbers. It's common for employees to befriend one another and form informal groups within an organization. The groups provide their members with camaraderie and information, but can create both challenges and benefits for the organization.

How should managers treat the grapevine? Certainly, it would be a mistake to try to eliminate it. People working together, day in and day out, are bound to communicate. A more rational approach is to recognize its existence. For example, managers should respond promptly and aggressively to inaccurate grapevine information to minimize the damage that such misinformation might do. Moreover, the grapevine can come in handy when managers are on the receiving end of important communications from the informal organization, such as when employees are expressing unhappiness with a recent action or have been recruited by a competitor.

In the next chapter, we apply these and other management concepts to an extremely important business function: the production of goods and services.

informal organization the pattern of behavior and interaction that stems from personal rather than official relationships

informal group a group created by the members themselves to accomplish goals that may or may not be relevant to an organization

grapevine the informal communications network within an organization

✓ Concept Check

- In what ways can informal groups affect a business?
- How is the grapevine used in a business organization?

Summary

7-1 Define an organization.

An organization is a group of two or more people working together to achieve a common set of goals. The relationships among positions within an organization can be illustrated by means of an organization chart. Five elements—job design, departmentalization, delegation, span of management, and chain of command—help to determine what an organization chart and the organization itself look like.

7-2 Explain why job specialization is important.

Job specialization is the separation of all the activities within an organization into smaller components and the assignment of those different components to different people. Several factors combine to make specialization a useful technique for designing jobs, but high levels of specialization may cause employee dissatisfaction and boredom. One technique for overcoming these problems is job rotation.

7-3 Identify the various bases for departmentalization.

Departmentalization is the grouping of jobs into manageable units. Typical bases for departmentalization are by function, product, location, or customer. Because each of these bases provides particular advantages, most firms—especially larger ones—use a combination of different bases to address different organizational situations.

7-4 Describe how decentralization follows from delegation.

Delegation is giving part of a manager's work to other workers. It involves the following three steps: (1) assigning responsibility, (2) granting authority, and (3) creating accountability. A decentralized firm is one that delegates power widely across various organization levels. In a centralized firm, on the other hand, power is retained at the upper levels.

7-5 Explore how the span of management describes an organization.

The span of management is the number of workers who report directly to a manager. Spans generally are characterized as wide (many workers per manager) or narrow (few workers per manager). Wide spans generally result in flat organizations (few layers of management); narrow spans generally result in tall organizations (many layers of management).

7-6 Identify four forms of organizational structure.

There are four basic forms of organizational structure. The line structure is the oldest and simplest structure, in which the chain of command moves in a straight line from person to person down through the levels of management. The line-and-staff structure is similar to the line structure, but adds specialists called staff managers to assist the line managers in decision making. The line structure works most efficiently for smaller organizations, whereas the line-and-staff structure is used by medium- and large-sized organizations. The matrix structure may be depicted as product departmentalization superimposed on functional departmentalization. With the matrix structure, an employee on a cross-functional team reports to both the project manager and the individual's supervisor in a functional department. In an organization with a virtual structure, the primary function performed internally is administration, and other functions are contracted out to other firms.

7-7 Examine the types, development, and uses of teams.

A large number of companies use teams to increase their employees' productivity. In a business organization, a team is two or more workers collaborating to achieve a shared mission, goal, or work product. A problem-solving team is a team of knowledgeable employees brought together to tackle a specific problem. Self-managed work teams involve groups of employees with the authority and skills to manage themselves. A cross-functional team is a team of individuals with varying specialties, expertise, and skills. A virtual team is a team consisting of members who are geographically dispersed and communicate electronically. The five stages of team development are forming, storming, norming, performing, and adjourning. The four roles within teams are task specialist, socioemotional, dual, and nonparticipative. Each of these roles plays a specific part in the team's interaction. For a team to be successful, members must learn how to resolve and manage conflict so that the team can work cohesively to accomplish goals. Teams have both benefits and limitations.

7-8 Describe how committees and task forces are used.

Organizations today use several types of formal committees that are typically brought together to represent members of the larger organization. Committees and task forces are used to develop organizational structure within an organization. An ad hoc committee is created for a specific short-term purpose, whereas a standing committee is relatively permanent. A task force is created to investigate a major problem or pending decision.

7-9 Explain the functions of the informal organization and the grapevine in a business.

Informal groups are created by group members to accomplish goals that may or may not be relevant to the organization, and they can be very powerful forces. The grapevine—the informal communications network within an organization—can be used to transmit information (important or gossip) through an organization much faster than through the formal communication network. Information transmitted through the grapevine can go in any direction across the organizational structure, skipping up or down levels of management and even across departments.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

organization (186)
organization chart (187)
chain of command (187)
job design (188)
job specialization (189)
job rotation (190)
departmentalization (190)
departmentalization by function (190)
departmentalization by product (191)
departmentalization by location (191)
departmentalization by customer (191)
delegation (193)
responsibility (193)
authority (193)
accountability (193)
decentralized organization (194)
centralized organization (194)
span of management (or span of control) (195)
organizational height (196)
line structure (196)
line managers (197)
line-and-staff structure (197)
staff managers (197)
matrix structure (198)
cross-functional team (198)
virtual structure (199)
team (200)
problem-solving team (200)
self-managed teams (200)
virtual team (201)
ad hoc committee (204)
standing committee (204)
task force (204)
informal organization (205)
informal group (205)
grapevine (205)

Discussion Questions

1. In what way do organization charts create a picture of an organization?
2. What determines the degree of specialization within an organization?
3. Describe how job rotation can be used to combat the problems caused by job specialization.
4. Why do most firms employ a combination of departmentalization bases?
5. How does a firm's top management influence its degree of centralization?
6. How is organization height related to the span of management?
7. Contrast line-and-staff and matrix forms of organizational structure.
8. Which kinds of firms would probably operate most effectively as centralized firms? As decentralized firms?
9. How do decisions concerning span of management and the use of committees affect organizational structure?
10. In what ways are team cohesiveness and team conflict related?
11. How do teams and committees differ?
12. How does the grapevine differ from formal communications within an organization?

Case 7

Sweetgreen Stays True to Its Roots

Sweetgreen, a farm-to-table salad chain, combines mission and passion to build healthier communities by connecting people to real food. The company is revolutionizing the salad business. Jonathan Neman, Nicolas Jammet, and Nathaniel Ru, who met in an entrepreneurship class at Georgetown University, set out to create healthy meals made from locally sourced ingredients. After raising $300,000 from 40 investors, Sweetgreen was born in 2007.

Neman says the founders' lack of experience in the restaurant industry contributed to their success because they were able to enter it with a fresh perspective. One of their earliest challenges was learning how to lead and effectively turn problems into growth opportunities. Sweetgreen created a safe space for innovation and experimentation through its structure and goals. Managers monitor objectives and key results (OKRs). OKR is a collaborative goal-setting framework used to define and track objectives and their outcomes with measurable results. The company has a so-called learning forward document to keep track of failures and learnings from those failed endeavors.

Sweetgreen's leadership team also strives to foster a culture of gratitude. Monthly, team members write gratitude cards to employees and customers. According to Neman, "culture really does eat strategy for breakfast." Strategy shifts and products change, but a strong, unwavering organizational culture is the foundation of the company. Their leadership style is not static, but evolves as the restaurant chain grows. Today, Sweetgreen enjoys a loyal following at more than 100 locations in ten states as well as Washington, DC.

The distribution element of Sweetgreen's marketing mix is perhaps the most compelling. The company has built an entire food ecosystem that elevates Sweetgreen from fast-casual restaurant to food platform. Sweetgreen has worked to digitize its business from start to finish, and now more than half of its orders originate on the Sweetgreen app. The salad chain also has an Outpost program that offers complimentary delivery to employees of participating companies. Employees order their meals in the morning, and they are delivered to a set drop point in select office buildings in the afternoon. Additionally, blockchain—a secure digital ledger for recording information—has been integrated into the salad start-up's supply chain, allowing it to trace its fresh fruits and vegetables from farm to table. Initially, Sweetgreen used the technology to research best times for harvesting and eating produce but expanded it to improve traceability and food safety.

Sweetgreen is also known for its seasonal dishes and often works with high-profile chefs such as Nancy Silverton. For example, Sweetgreen purchased Koginut squash seeds from Row 7 Seed Company, which develops seeds for produce, and gifted the seeds to farming partners across the country. Sweetgreen purchased the resulting Koginut squash and sold it in a limited-time-only entree nationwide. The company announced the dish's arrival with a billboard in Times Square. Jammet says the company likes to "look outside the food world" to find inspiration for its promotion strategy.

The company's focus on health, wellness, and sustainable practices resonates with its core customer group: young professionals who put their money where their values are. Sweetgreen's corporate culture and marketing strategy have made its salads stand out in a category that often feels unexciting. The company has a modern supply chain, local supply chain partners, a focus on sustainability, consistent storytelling, and a popular app and loyalty program. Though it has attracted criticism for its products' high price tags, Sweetgreen pays it forward by increasing employee wages and benefits. The company, which has been valued at more than $1 billion, has experienced profitable growth. With cash from eager investors lining its pockets, Sweetgreen is poised to take off across the country.[9]

Questions

1. How has blockchain technology improve Sweetgreen's supply chain?
2. Describe the organizational culture at Sweetgreen.
3. How does management at Sweetgreen track objectives and their outcomes?

Building Skills for Career Success

1. Social Media Exercise

Zappos has a reputation for being customer-centered, meaning it embraces the notion that customers come first. One of the ways that it allows employees to communicate with customers is through its blog: www.zapposinsights.com.

1. Take a look at this blog. What can you tell about the culture of Zappos?
2. How does it approach customer service? Do you think it works? Why or why not?

2. Building Team Skills

An organization chart is a diagram showing how employees and tasks are grouped and how the lines of communication and authority flow within an organization. These charts can look very different depending on a number of factors, including the nature and size of the business, the way it is departmentalized, its patterns of delegating authority, and its span of management.

Assignment

1. Working in a team, use the following information to draw an organization chart: The KDS Design Center works closely with two home-construction companies, ACME Homebuilders and Highmass. KDS's role is to help customers select materials for their new homes and to ensure that their selections are communicated accurately to the builders. The company is also a retailer of wallpaper, blinds, and drapery. The retail department, the ACME Homebuilders accounts, and the Highmass accounts make up KDS's three departments. The company has the following positions: president, executive vice president, managers, two appointment coordinators, two ACME Homebuilders coordinators, two Highmass coordinators, two consultants/designers for the Amex and Highmass accounts, 15 retail positions, and four payroll and billing personnel.
2. After your team has drawn the organization chart, discuss the following:
   a. What type of organizational structure does your chart depict? Is it a line, line-and-staff, matrix, or virtual structure? Why?
   b. How does KDS use departmentalization?
   c. To what extent is authority in the company centralized or decentralized?
   d. What is the span of management within KDS?
   e. Which positions are line positions and which are staff? Why?

3. Prepare a three-page report summarizing what the chart revealed about relationships and tasks at the KDS Design Center and what your team learned about the value of organization charts. Include your chart in your report.

3. Researching Different Careers

In the past, company loyalty and the ability to assume increasing job responsibility usually ensured advancement within an organization. While the reasons for seeking advancement (the desire for a better-paying position, more prestige, and job satisfaction) have not changed, the qualifications for career advancement have. In today's business environment, climbing the corporate ladder requires packaging and marketing yourself. To be promoted within your company or to be considered for employment with another company, it is wise to improve your skills continually. By taking workshops and seminars or enrolling in community college courses, you can keep up with the changing technology in your industry. Networking with people in your business or community can help you find a new job. Most jobs are filled through personal contacts, proving that who you know can be important.

A list of your accomplishments on the job can reveal your strengths and weaknesses. Setting goals for improvement helps to increase your self-confidence.

Be sure to recognize the signs of job dissatisfaction. If you are feeling unhappy in your job, it may be time to move to another position or company.

Assignment

Are you prepared to climb the corporate ladder? Do a self-assessment by analyzing the following areas and summarize the results in a two-page report.

1. Skills
    - What are your most valuable skills?
    - What skills do you lack?
    - Describe your plan for acquiring new skills and improving your existing skills.
2. Networking
    - How effective are you at using a mentor?
    - Are you a member of a professional organization?
    - In which community, civic, or church groups are you participating?
    - Whom have you added to your contact list in the last six weeks?
3. Accomplishments
    - What achievements have you reached in your job?
    - What would you like to accomplish? What will it take for you to reach your goal?
4. Promotion or new job
    - What is your likelihood for getting a promotion?
    - Are you ready for a change? What are you doing or willing to do to find another job?

Chapter

8

GORODENKOFF/SHUTTERSTOCK.COM

Producing Quality Goods and Services

Why Should You Care?

Think for a moment about the products and services you bought in the past week. Those products and services could not be produced if it weren't for the production activities described in this chapter and that means consumers like you would not be able to purchase the products and services they need or want.

Learning Objectives

Once you complete this chapter, you will be able to:

8-1 Explain the nature of production.

8-2 Outline how the conversion process transforms raw materials, labor, and other resources into finished goods or services.

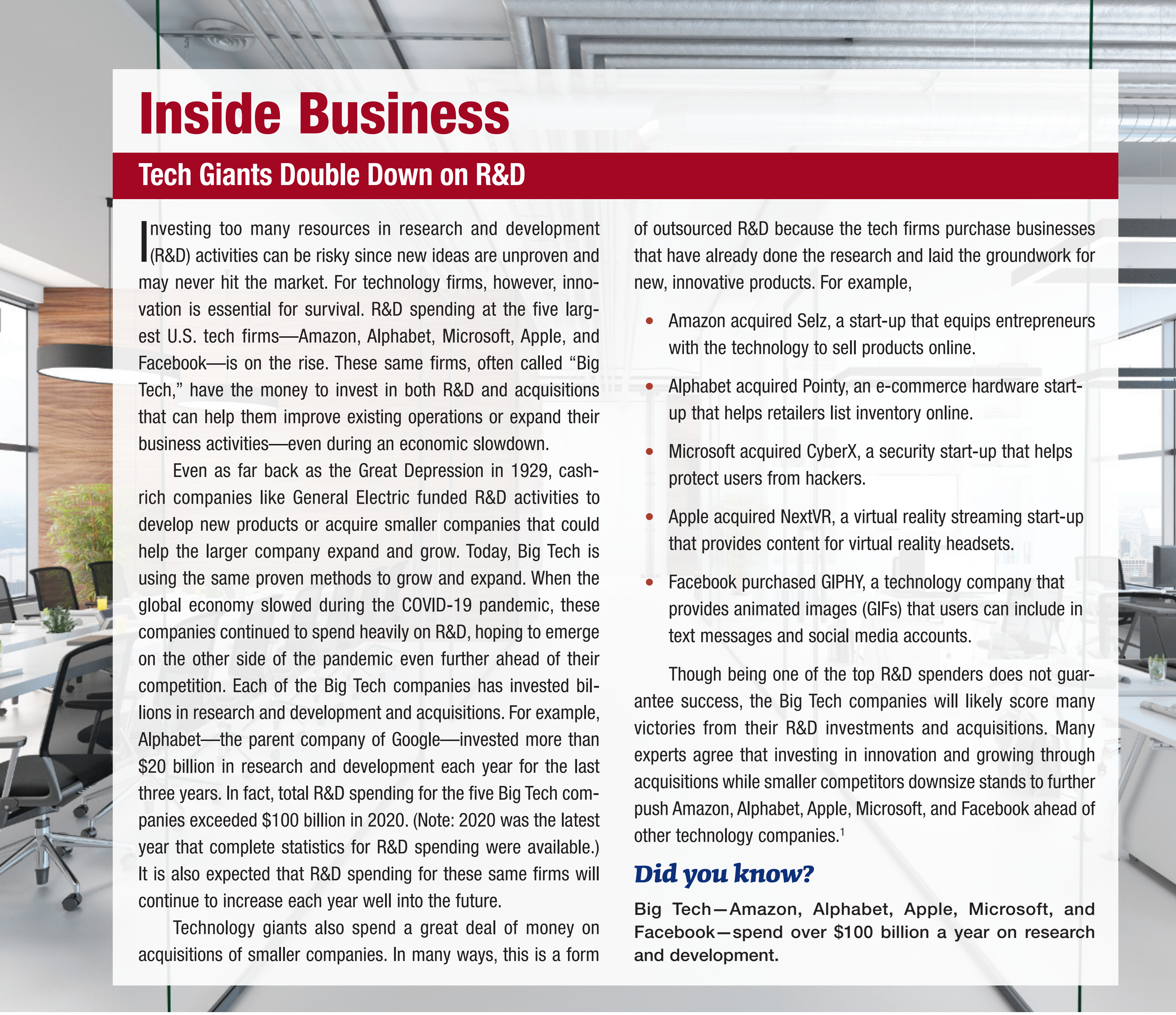
8-3 Discuss the importance of service businesses to consumers, other business firms, and the nation's economy.

8-4 Describe how research and development leads to new products and services.

8-5 Discuss the components involved in planning the production process.

8-6 Explain how purchasing, inventory control, scheduling, and quality control affect production.

8-7 Summarize how technology can make American firms more productive and competitive in the global marketplace.



Inside Business

Tech Giants Double Down on R&D

Investing too many resources in research and development (R&D) activities can be risky since new ideas are unproven and may never hit the market. For technology firms, however, innovation is essential for survival. R&D spending at the five largest U.S. tech firms—Amazon, Alphabet, Microsoft, Apple, and Facebook—is on the rise. These same firms, often called "Big Tech," have the money to invest in both R&D and acquisitions that can help them improve existing operations or expand their business activities—even during an economic slowdown.

Even as far back as the Great Depression in 1929, cash-rich companies like General Electric funded R&D activities to develop new products or acquire smaller companies that could help the larger company expand and grow. Today, Big Tech is using the same proven methods to grow and expand. When the global economy slowed during the COVID-19 pandemic, these companies continued to spend heavily on R&D, hoping to emerge on the other side of the pandemic even further ahead of their competition. Each of the Big Tech companies has invested billions in research and development and acquisitions. For example, Alphabet—the parent company of Google—invested more than $20 billion in research and development each year for the last three years. In fact, total R&D spending for the five Big Tech companies exceeded $100 billion in 2020. (Note: 2020 was the latest year that complete statistics for R&D spending were available.) It is also expected that R&D spending for these same firms will continue to increase each year well into the future.

Technology giants also spend a great deal of money on acquisitions of smaller companies. In many ways, this is a form of outsourced R&D because the tech firms purchase businesses that have already done the research and laid the groundwork for new, innovative products. For example,

- Amazon acquired Selz, a start-up that equips entrepreneurs with the technology to sell products online.
- Alphabet acquired Pointy, an e-commerce hardware start-up that helps retailers list inventory online.
- Microsoft acquired CyberX, a security start-up that helps protect users from hackers.
- Apple acquired NextVR, a virtual reality streaming start-up that provides content for virtual reality headsets.
- Facebook purchased GIPHY, a technology company that provides animated images (GIFs) that users can include in text messages and social media accounts.

Though being one of the top R&D spenders does not guarantee success, the Big Tech companies will likely score many victories from their R&D investments and acquisitions. Many experts agree that investing in innovation and growing through acquisitions while smaller competitors downsize stands to further push Amazon, Alphabet, Apple, Microsoft, and Facebook ahead of other technology companies.[1]

Did you know?

Big Tech—Amazon, Alphabet, Apple, Microsoft, and Facebook—spend over $100 billion a year on research and development.

Challenges! How does a successful company continue to innovate and expand during an economic slowdown? It's a good question. And yet, for successful cash-rich Big Tech firms Amazon, Alphabet, Apple, Microsoft, and Facebook, they keep on investing in R&D and acquiring smaller companies that can fuel their growth into the future. The fact is, innovation for Big Tech companies is not an option, but an essential part of planning for future growth and expansion. Executives for these same companies would be the first to tell you that many of the topics covered in this chapter—research and development, facilities planning, purchasing, quality control, scheduling, and automation—are key factors that have enabled their businesses to grow and meet increased customer demand.

We begin this chapter with an overview of operations management—the activities required to produce goods and services that meet the needs of customers.

In this section, we also discuss the role of manufacturing in the U.S. economy, competition in the global marketplace, and careers in operations management. Next, we describe the conversion process that makes production possible and also note the growing role of services in our economy. Then we examine more closely three important aspects of operations management: developing ideas for new products, planning for production, and effectively controlling operations after production has begun. We close the chapter with a look at the productivity trends and the ways that manufacturing can be improved through automation, robotics, and technology.

8-1 What Is Production?

Learning Objective

8-1 Explain the nature of production.

Have you ever wondered if you could buy toilet paper and cleaning supplies the next time you went to Walmart, Target, or Walgreens? During the COVID-19 pandemic, many people faced shortages when they went to stores to buy essential products. For some consumers, the next step was to order needed products online from Amazon or other online retailers—only to receive a message that many of the same items were out of stock and there would be a delay before shipment. Shortages like these were common, and they underscore the importance of the activities described in this chapter. In fact, these products and services and millions of others like them would not exist if it weren't for production activities.

Let's begin this chapter by reviewing what an operating manager does. In Chapter 6, we described an *operations manager* as a person who manages the systems that convert resources into goods and services. This area of management is usually referred to as **operations management**, which consists of all the activities required to produce goods and services.

To produce a product or service successfully, a business must perform a number of specific activities. For example, the driving force behind the new General Motors Hummer has been to create a new kind of truck and SUV that is powered by a 1,000-horsepower electric motor. Although the 2022 model was available in late 2021, General Motors (GM) had to do a lot of research and development before the company could begin the production process. Marketing research had to determine not only if customers were willing to pay the base price—$80,000—for this all-electric vehicle (EV), but also what additional features they wanted. Marketing research also had to determine how the Hummer would compare against the competition including trucks and SUVs produced by Ford, Toyota, Nissan, Chevrolet, and GMC.

Once initial marketing research was completed, General Motors' product designers and operations managers began the process to turn the idea into reality. GM's managers couldn't just push the "start button" and immediately begin producing the new Hummer. As you will see, planning took place both *before* anything was produced and *during* the production process.

Managers were also concerned with the control of operations to ensure that the organization's goals were achieved. For a product such as the electric Hummer, control of operations involved a number of important issues, including product quality, performance standards, the amount of inventory of both raw materials and finished products, and production costs.

We discuss each of the major activities of operations management later in this chapter. First, however, let's take a closer look at American manufacturers and how they compete in the global marketplace.

8-1a How American Manufacturers Compete in the Global Marketplace

After World War II, the United States became the most productive country in the world. For almost 30 years, until the late 1970s, its leadership was never threatened.

operations management all the activities required to produce goods and services

Today, however, manufacturers in China, Mexico, Japan, Germany, South Korea, India, and other industrialized nations from around the globe are competing with U.S. firms and they are producing electronic equipment, automobiles, software, clothing, and many other items. And yet, in the face of increasing competition, there is both good and bad news for U.S. manufacturers. First the bad news.

DUSAN PETKOVIC/SHUTTERSTOCK.COM

Tablets and flat screen TVs: Products we take for granted. Have you thought about what it takes to produce these products? If it weren't for the production activities—research and development, design planning, operations control, and robotics and computer-aided manufacturing—described in this chapter, these products wouldn't exist.

The Bad News for Manufacturers The number of Americans employed in the manufacturing sector has decreased. Back in 1960, one in four Americans worked in manufacturing. Today, about one in ten work in manufacturing. Overall, just over 12 million U.S. workers are employed in manufacturing jobs—down from just over 17 million back in 2000.[2]

While there are many additional factors, one major factor explains why employment in this economic sector has declined. Many of the U.S. manufacturing jobs that were lost were outsourced to low-wage workers in nations where there are few labor, safety, and environmental regulations. As a result, manufacturing accounts for 8.6 percent of the current U.S. workforce.[3] Since 2000, five million jobs have been lost, and many of those jobs aren't coming back. Experts at the U.S. Bureau of Labor Statistics (BLS) don't forecast an increase in manufacturing jobs between now and the year 2029.[4]

The Good News for Manufacturers Although China has been the most competitive manufacturer in the world for the last few years, the United States is expected to regain the number one spot because of its investment in technology and innovation.[5] While some people would argue that "Made in America" doesn't mean what it used to mean, consider the following:

- U.S. manufacturers produce approximately 18 percent of total global manufacturing output;[6]
- Every year, manufacturing accounts for approximately 11 percent of the U.S. gross domestic product;[7]
- Manufacturing exports are approximately 60 percent of all U.S. exports;[8]
- Compared to other economic activities, manufacturing has a huge multiplier effect. For every $1 spent in manufacturing, an additional $2.74 is generated in the nation's economy because of purchases from suppliers and businesses that support manufacturers; and[9]
- The average manufacturing employee in the United States earns approximately $88,400, including pay and benefits.[10]

As a result, the manufacturing sector is still a very important part of the U.S. economy. Although the number of manufacturing jobs has declined since 2000, manufacturers are working hard to compete in the global marketplace. At least two very important factors are making U.S. manufacturers more competitive: First, innovation—finding a better way to produce products—is the key factor that has enabled American manufacturers to compete in the global marketplace. Second, today's workers in the manufacturing sector are highly skilled in order to operate sophisticated equipment. Simply put, Americans are making more goods, but with fewer employees.

OLIVIER LE MOAL/SHUTTERSTOCK.COM

There's even more good news for manufacturers. There is a renewed interest in preserving existing manufacturing jobs and creating incentives for manufacturing firms to "do business in America." As a result, many American manufacturers that outsourced work to factories in foreign nations are once again beginning to manufacture goods in the United States. For our purposes, the term **reshoring** (sometimes referred to as onshoring or insourcing) describes a situation where U.S. manufacturers bring manufacturing jobs back to the United States. For example, Apple, Ford, General Motors, Walmart, and many other U.S. firms are involved in reshoring. The primary reasons why U.S. firms are "coming back home" include increasing labor costs in foreign nations, higher shipping costs, significant quality and safety issues, faster product development when goods are produced in the United States, and federal and state subsidies to encourage manufacturers to produce products in the United States. There is also a renewed interest in reshoring after business firms (and the nation) experienced shortages caused by the COVID-19 pandemic. The disruptions in global manufacturing and the limited access to foreign goods, services, and materials caused many business executives to reconsider the benefits of producing goods in the United States. In fact, some would argue that reshoring is an important part of our nation's ability to survive future crises.

The bottom line: The global marketplace has never been more competitive. Successful U.S. manufacturers must meet current and future challenges and will need to focus on the following:

1. Meeting the needs of customers and improving product quality.
2. Motivating employees to cooperate with management and improve productivity.
3. Reducing costs by selecting suppliers that offer higher-quality raw materials and components at reasonable prices.
4. Using robotic, computer-aided systems and flexible manufacturing systems that allow a higher degree of customization.
5. Improving procedures to lower manufacturing costs.
6. Using green manufacturing to conserve natural resources and sustain the planet.

For most firms, competing in the global marketplace is not only profitable but also an essential activity that requires the cooperation of everyone within the organization.

✓ Concept Check

- What steps were necessary for General Motors to transform the idea for manufacturing an electric Hummer truck or SUV to an actual product?
- What steps have U.S. firms taken to regain a competitive edge in the global marketplace?
- What is the difference between an analytical and a synthetic manufacturing process? Give an example of each type of process.

8-1b Careers in Operations Management

Although it is hard to provide information about specific career opportunities in operations management, some generalizations do apply to this management area. A basic understanding of mass production and the difference between an analytical process and a synthetic process is essential. **Mass production** is a manufacturing process that lowers the cost required to produce a large number of identical or similar products over a long period of time. An **analytical process** breaks raw materials into different component parts. For example, a barrel of crude oil refined by Marathon Oil Corporation—a Texas-based oil and energy exploration company—can be broken down into gasoline, oil, lubricants, and many other petroleum by-products.

reshoring a situation in which U.S. manufacturers bring manufacturing jobs back to the United States

mass production a manufacturing process that lowers the cost required to produce a large number of identical or similar products over a long period of time

analytical process a process in operations management in which raw materials are broken into different component parts

A **synthetic process** is just the opposite of the analytical one; it combines raw materials or components to create a finished product. Stanley Black & Decker uses a synthetic process when it combines plastic, steel, rechargeable batteries, and other components to produce a cordless drill.

Once you understand that operations managers are responsible for producing tangible goods or services that customers want, you must determine how you could be involved in the production process. Today's successful operations managers must:

1. Be able to motivate and lead people;
2. Understand how technology can make a manufacturer more productive;
3. Appreciate the cost-control processes that help lower production costs and improve product quality; and
4. Understand the relationship between the customer, the marketing of a product, and the production of a product.

If operations management seems like an area you might be interested in, why not do more career exploration?

synthetic process a process in operations management in which raw materials or components are combined to create a finished product

Entrepreneurial Success

Entrepreneurs and Digital Manufacturing

Manufacturing is an old industry, and U.S. employment in this industry is declining. And yet, these two factors don't mean that there aren't opportunities for today's manufacturing businesses. In fact, U.S. manufacturers produce approximately 18 percent of total global manufacturing output, and the industry is taking steps to innovate. That's where entrepreneurs come in.

A full-scale tech revolution has already begun with companies utilizing augmented reality, robots, artificial intelligence, cloud-based technology, and more. For example, 3D printing (sometimes called additive manufacturing) has been around for some time and was developed to help manufacturers create prototypes using plastics and other materials for promising ideas that often lead to production of new products. Now, entrepreneur Hanan Gothait, the CEO and founder of XJet, has developed a 3D printer that enables users to create revolutionary products in ceramic and metal. The ability to produce products in ceramic and metal creates a number of opportunities for innovative manufacturers.

In addition to 3D printing, a growing number of small start-up businesses are using new digital tools, computers, and software to change the way many items are manufactured in both small and large companies. Arculus, a German software company, has developed a "modular production platform" that uses artificial intelligence and autonomous robots to manufacture products. Using Arculus technology allows car manufacturers to change traditional assembly lines into a modular, multidimensional production system to accommodate flexible production and fluctuating demand and improve productivity. The Arculus system can also be adapted to produce other products including consumer electronics and appliances.

Often, venture capitalist firms provide needed financing to help entrepreneurs to turn an idea into new products or services. One venture capitalist firm, Playground Global, LLC, does even more than supply funding. Operating in what used to be a 70,000 square foot apricot canning factory, Playground Global now has a group of engineers, designers, and technology experts working in five world-class labs to help entrepreneurs with promising ideas create new products and services.

The bottom line: Many experts believe entrepreneurs with new ideas that are changing the way products and services are produced and the increased use of technology are pushing the manufacturing industry into a "new industrial revolution" that will continue for years.

Sources: Based on information in Trevor English, "How 3D Printing Has Changed the Manufacturing World," *Interesting Engineering*, March 22, 2020, www.interestingengineering.com/how-3d-printing-has-changed-the-manufacturing-world; Zac Johnson, "How to Start a Manufacturing Business," *YSF Magazine*, October 23, 2018, www.yfsmagazine.com/2018/10/23/start-a-manufacturing-business; Sarah Goehrke, "3D Printing Entrepreneurship And Innovation: Behind The Scenes With XJet's Hanan Gothait," *Forbes*, October 23, 2019, www.forbes.com/sites/sarahgoehrke/2019/10/23/3-d-printing-entrepreneurship-and-innovation-behind-the-scenes-with-hanan-gothait; Arculus, "About - Arculus Modular Production," https://www.arculus.de; Mark Muro, "Entrepreneurs Take on Manufacturing," *Harvard Business Review*, February 22, 2016, www.hbr.org/2016/02/entrepreneurs-take-on-manufacturing.

8-2 The Conversion Process

Learning Objective

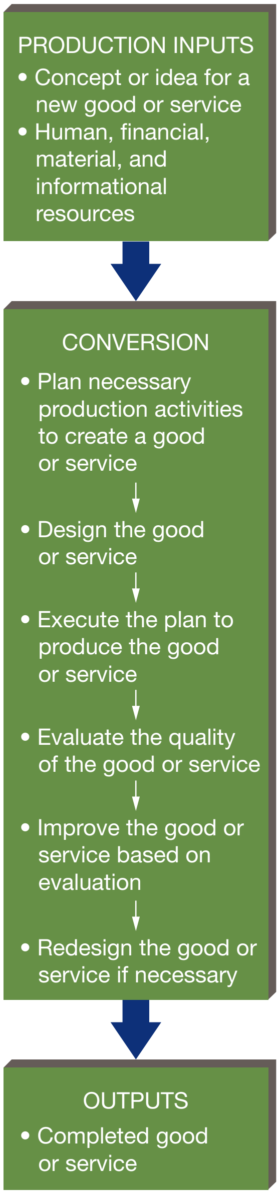
8-2 Outline how the conversion process transforms raw materials, labor, and other resources into finished goods or services.

The purpose of a manufacturing or a service business is to provide utility to customers. **Utility** is the ability of a good or service to satisfy a human need. Although there are four types of utilities—form, place, time, and possession—operations management focuses primarily on form utility. **Form utility** is created by people converting raw materials, finances, and information into finished products or services. The other types of utility—place, time, and possession—are discussed in Chapter 11.

But how does the conversion take place? How does Kellogg's convert corn, sugar, salt, and other ingredients; money from previous sales and stockholders' investments; production workers and managers; and economic and marketing forecasts into Frosted Flakes cereal products? How does H&R Block employ more than 3,500 full-time employees and thousands of part-time tax preparers and convert retail locations, computers and software, and advertising and promotion into tax services for its clients? They do so through the use of a conversion process like the one illustrated in Figure 8-1. As indicated by our H&R Block example, the conversion process can be used to produce services.

Figure 8-1 The Conversion Process

The conversion process converts ideas and resources into useful goods and services.


PRODUCTION INPUTS
• Concept or idea for a new good or service
• Human, financial, material, and informational resources
CONVERSION
• Plan necessary production activities to create a good or service
• Design the good or service
• Execute the plan to produce the good or service
• Evaluate the quality of the good or service
• Improve the good or service based on evaluation
• Redesign the good or service if necessary
OUTPUTS
• Completed good or service

8-2a Production Using a Conversion Process

The conversion of resources into products and services can be described in several ways. We limit our discussion here to three: the focus, or major resource, used in the conversion process; its magnitude of change; and the number of production processes employed.

Focus or Major Resource By the *focus* of a conversion process, we mean the resource or resources that make up the major or most important *input*. The resources are financial, material, information, and people—the same resources discussed in Chapters 1 and 6. For a bank such as Citibank, financial resources are the major resource. A chemical and energy company, such as Chevron, concentrates on material resources. Your college or university is concerned primarily with information. And temporary employment services, such as Manpower, focus on the use of human resources.

Magnitude of Change The *magnitude of change* of a conversion process is the degree to which the resources are physically changed. At one extreme lie such processes as the one by which the Glad Products Company produces Glad® ClingWrap. Various chemicals in liquid or powder form are combined to produce long, thin sheets of plastic Glad ClingWrap. Here, the original resources are totally unrecognizable in the finished product. At the other extreme, Southwest Airlines produces no physical change in its original resources. The airline simply provides a service and transports people from one location to another.

Number of Production Processes A single firm may employ one production process or many. In general, larger firms that produce a variety of products or services use multiple production processes. For example, GE manufactures some of its own products, buys other merchandise from suppliers, and operates multiple divisions including a finance division, a renewable energy division, an aviation division, a healthcare division, and other divisions responsible for the products and services that customers associate with the GE name. Smaller firms, by contrast, may use one production process. For example, Advanced Architectural Stone, Inc., manufactures one basic product: building materials made from concrete.

8-3 The Increasing Importance of Services

The application of the principles of operations management to the production of services has coincided with a dramatic growth in the number and diversity of service businesses. In 1900, only 28 percent of American workers were employed in service firms. By 1950, this figure had grown to 40 percent, and by the beginning of 2021, it had risen to 86 percent.[11] In fact, the American economy is now characterized as a service economy (refer to Figure 8-2). A **service economy** is one in which more effort is devoted to the production of services than to the production of goods.

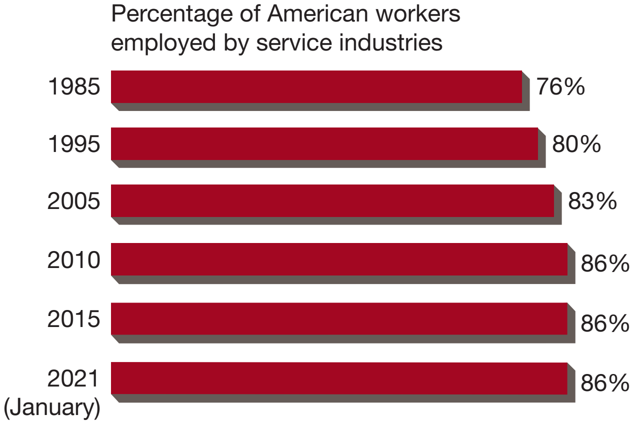
8-3a Planning Quality Services

Today, the managers of restaurants, laundries, real estate agencies, banks, movie theaters, airlines, travel bureaus, hospitals, and other service firms have realized that they can benefit from the experience of manufacturers. And while service firms are different from manufacturing firms, both types of businesses must complete many of the same activities in order to be successful. For example, as illustrated in the middle section of Figure 8-1, service businesses must plan, design, execute, evaluate, improve, and redesign their services in order to provide the services that their customers want.

For a service firm, planning often begins with determining who the customer is and what needs the customer has. After customer needs are identified, the next step for successful service firms is to develop a plan that will enable the firm to deliver the services that their customers want or need. For example, a swimming pool repair business must develop a business plan that includes a process for hiring and training qualified employees, obtaining necessary parts and supplies, marketing the firm's services, and creating management and accounting systems to control the firm's activities. Once the firm provides a service to a customer, successful firms evaluate the way they operate and measure customer satisfaction. And if necessary, they redesign their services to improve the customer's experience.

Figure 8-2 Service Industries

The growth of service firms has increased so dramatically that we now live in what is referred to as a service economy.



Source: "Employment by Major Industry Sector," The Bureau of Labor Statistics website at https://www.bls.gov/ (accessed February 3, 2021).

✓ Concept Check

- Explain how utility is related to form utility.
- In terms of focus, magnitude of change, and number, characterize the production processes used by a local pizza parlor, a dry-cleaning establishment, and a company that makes children's clothing.

Learning Objective

8-3 Discuss the importance of service businesses to consumers, other business firms, and the nation's economy.

utility the ability of a good or service to satisfy a human need

form utility utility created by people converting raw materials, finances, and information into finished products or services

service economy an economy in which more effort is devoted to the production of services than to the production of goods

MONKEY BUSINESS IMAGES/SHUTTERSTOCK.COM

Who answers your questions when you call a company to ask about a product or service? Answer: People who work in a company's call center. Answering questions on the phone or online queries is one-way customers obtain the answers or information they need. If a company doesn't provide good customer service, customers often post bad online reviews, tell family and friends about a company's poor customer service, or buy from another business when they make additional purchases.

8-3b Evaluating the Quality of a Firm's Services

The production of services is very different from the production of manufactured goods in the following five ways:

1. Service firms do not produce a product unless the customer wants or needs it.
2. Services are consumed immediately and, unlike manufactured goods, cannot be stored. For example, a hair stylist cannot store completed haircuts.
3. Services can be provided any place and are often provided when and where the customer desires the service.
4. Services are usually labor-intensive because the human resource is often the most important resource used in the production of services.
5. Services are intangible, and it is therefore more difficult to evaluate customer satisfaction.[12]

Compared with manufacturers, service firms often listen more carefully to customers and respond more quickly to the market's changing needs. For example, Maggiano's Little Italy restaurant is a chain of eating establishments owned by Brinker International. In order to continuously improve customer service, the restaurant encourages diners to complete online surveys that prompt diners to evaluate the food, atmosphere, service, and other variables. The information from the surveys is then used to fine-tune the way Maggiano's meets its customers' needs. As an incentive to complete the survey, Maggiano's gives diners a chance to win $1,000. Other restaurants often give diners free food the next time they visit a restaurant.

✓ Concept Check

- How is the production of services similar to the production of manufactured goods?
- How is the production of services different from the production of manufactured goods?
- How can service firms measure customer satisfaction?

8-4 Where Do New Products and Services Come From?

Learning Objective

8-4 Describe how research and development leads to new products and services.

Question: Which of the following companies are developing an autonomous (driverless) automobile?

a. Mercedes-Benz
b. Google
c. Tesla
d. Amazon
e. Nissan

Answer: All of the companies listed above are using research and development to develop a car that can drive for you. In addition, Ford, Toyota, General Motors, and others are also working on driverless automobiles. Even more astonishing, Google—a company known for its search engine—and Amazon—the online retailer—are testing their own versions of an autonomous car that will turn each company's idea into a marketable product. New products—like an autonomous car—start with an idea. Then assuming an idea has potential, a company's research and development activities turn the idea into a reality.

8-4a **Research and Development**

GORODENKOFF/SHUTTERSTOCK.COM

Microchips may be the most important part of a new product. In today's technological world, microchips are a major component in many products that we buy. But did you ever think about how we got microchips in the first place? The first microchips were the result of research and development activities by Robert Noyce and Jack Kilby—both engineers. Today, engineers, like the one in this photo, are using many of the same R&D activities to develop the next generation of microchips.

While the COVID-19 pandemic may have started in China in late 2019, it quickly spread around the globe. Increasing numbers of cases *and* deaths were reported. In many counties, emergency rooms and hospitals were full, and doctors and nurses could not keep up with the increasing number of patients. Existing vaccines didn't work on this virus, and health professionals and politicians weren't sure what they should do to combat this deadly pandemic. For many experts, the hope of a vaccine was a dream that became a reality by late 2020. Two different vaccines were developed by Moderna and a joint venture between Pfizer and BioNTech—three of the largest pharmaceutical companies in the world. Both vaccines were approved for emergency use in December 2020 by the U.S. Food and Drug Administration (FDA). While it takes much longer to develop and obtain approval for most new medicines and vaccines, the research and development activities of both firms made it happen in record time. Even though both vaccines are now available, Moderna and the joint venture between Pfizer and BioNTech continue to research ways to improve the initial vaccines to protect people from new strands of the virus. The activities that led to the creation of both vaccines generally are referred to as research and development. For our purposes, **research and development (R&D)** involves a set of activities intended to identify new ideas that have the potential to result in new goods and services.

Today, business firms use three general types of R&D activities. *Basic research* consists of activities aimed at uncovering new knowledge. The goal of basic research is scientific advancement, without regard for its potential use in the development of goods and services. *Applied research,* in contrast, consists of activities geared toward discovering new knowledge with some potential use. *Development and implementation* involves research activities undertaken specifically to put new or existing knowledge to use in producing goods and services. For many companies, R&D is a very important part of their business operations. The 3M company, for example, has always been known for its development and implementation research activities. Currently, 3M employs 8,000 researchers worldwide and has invested over $5.6 billion over the last three years to develop new products designed to make people's lives easier and safer.[13]

8-4b **Product Extension and Refinement**

If a firm sells only one product or service, when customers quit buying the product or service, the firm will die. To stay in business, the firm must, at the very least, find ways to refine or extend the want-satisfying capability of its product or service. Consider television sets. Since they were introduced in the early 1930s, television sets have been constantly *refined* so that they now provide clearer, sharper pictures with less dial adjusting. Larger televisions are now available, and prices have dropped because manufacturers are using the latest automation and technology in their production facilities. During the same time, television sets also were *extended*. There are basic flat-screen televisions without added features, and many others that include Smart Technology and Apps that can be used to access the internet and streaming services like Netflix, Hulu, and Peacock. Although it seems like LED televisions were

research and development (R&D) a set of activities intended to identify new ideas that have the potential to result in new goods and services just introduced, already manufacturers like Samsung, LG, and Sony are taking the next step and developing QLED, Quantum Dots, and other technologies that will provide even better pictures on your TV screen.

For most firms, extension and refinement are expected results of their research, development, and implementation activities. Each refinement or extension results in an essentially "new" product whose sales make up for the declining sales of a product that was introduced earlier. When consumers were introduced to the original five varieties of Campbell's Soup, they discovered that these soups were of the highest quality, as well as inexpensive, and the soups were an instant success. Although one of the most successful companies at the beginning of the 1900s, Campbell's had to continue to innovate, refine, and extend its product line. To meet this need, Campbell's Soup has developed ready-to-serve products that can be popped into a microwave at work or school. As further evidence of its commitment to product extension and refinement, Campbell introduced Well Yes Soups—an entirely new gourmet soup line created with new recipes that blend traditional favorites with new vegetables and other ingredients to create new soups including Italian Style Wedding Soup, Tomato Sweet Basil Soup, and Roasted Chicken and Vegetable Soup. In fact, because of product extension, Campbell's Soup now has more than 80 soup varieties. And while it may be obvious, the goal of the company's product extension and refinement efforts is to maintain its loyal customer base and at the same time attract new customers to new and different soup products.

✓ Concept Check

- Describe how research and development leads to new products.
- What is the difference between basic research, applied research, and development and implementation?
- Explain why product extension and refinement are important.

Sustaining the Planet

How to Build Sustainable and Resilient Manufacturing

During the COVID-19 pandemic, many factory slowdowns or closures around the world forced manufacturers to adapt existing production methods to cope with a shortage of employees, resources, and supplies. Despite shortages and an economic slowdown, many manufacturers used technology to improve productivity and meet consumer demand for products that were in short supply. As a bonus, the unprecedented slowdown in industrial activity curbed global carbon emissions, indicating that substantial and significant change is possible when different methods and more technology are used to produce products or services.

Today, successful manufacturers are always looking for ways to improve. For example, manufacturers know that converting raw materials into finished products is both a costly and energy-intensive process. And yet, one way to reduce cost is using renewable energy. Leveraging solar energy and solar energy storage solutions, for example, can accommodate flexible demand for consumer products. Method Products, Inc., a natural cleaning products company with locations in the United States and Europe, uses multiple renewable energies. It has a wind turbine, a greenhouse, and solar panels that track the sun at its factory outside of Chicago. Method Products is also using more renewable energy in their other production facilities. Other manufacturers are evaluating not only how to conserve natural resources, but also how their products impact the environment. Nestlé, for example, uses a life cycle assessment (LCA) framework to evaluate and minimize the environmental impact of the products they manufacture.

As a result of shortages of both needed resources and finished goods and the problems manufacturers encountered during the pandemic, sustainability in manufacturing has now taken center stage. This new interest in sustainability, the digital workplace, and technology is helping all types of manufacturers to increase productivity and profitability, and to cope with an ever-changing business environment.

Sources: Blake Moret and Allie Schwertner, "Why Sustainable Manufacturing Makes Economic as Well as Ethical Sense," *World Economic Forum*, August 4, 2020, www.weforum.org/agenda/2020/08/sustainable-manufacturing-economic-and-ethical; Graham Immerman, "Building a Sustainable, Resilient Industry for the Future," *Smart Industry*, June 17, 2020, www.smartindustry.com/blog/smart-industry-connect/building-a-sustainable-resilient-industry-for-the-future; Method, "Our Soap Factory," https://methodhome.com/beyond-the-bottle/soap-factory.

8-5 How Do Managers Plan Production?

Learning Objective

8-5 Discuss the components involved in planning the production process.

Only a few of the many ideas that are considered by a firm's research and development employees ever reach the production stage. For those ideas that do, however, the next step is planning for production. Planning for production involves three different phases: design planning, facilities planning, and operational planning (refer to Figure 8-3).

8-5a Design Planning

When the R&D staff at Samsung recommended to top management that the firm manufacture and market a "Family Hub" refrigerator, with a touch screen, Wi-Fi connectivity, and apps that allow consumers to connect with family members, provide recipe suggestions, manage their grocery lists, or even see who is at the front door, the company could not simply swing into production the next day. Instead, a great deal of time and energy had to be invested in determining what the new refrigerator would look like, where and how it would be produced, and what options would be included. These decisions are a part of design planning. **Design planning** is the development of a plan for converting an idea into an actual product or service. The major decisions involved in design planning deal with product line, required capacity, and use of technology.

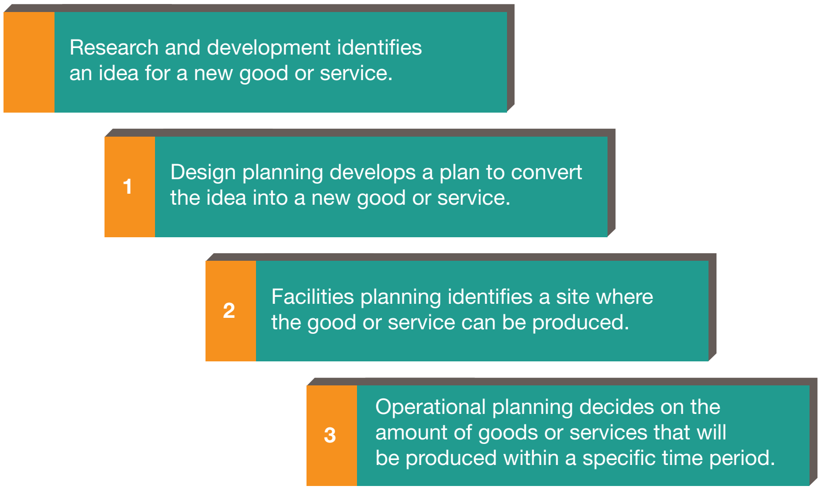
Product Line A **product line** is a group of similar products that differ only in relatively minor characteristics. During the design-planning stage, a manufacturer like Samsung must determine how many different models to produce and what options to offer. Likewise, a restaurant chain such as Pizza Hut must decide how many menu items to offer.

An important issue in deciding on the product line is to balance customer preferences and production requirements. Typically, a company's marketing personnel want a "long" product line with more options to give customers greater choice. On the other hand, operations managers and production personnel generally want a "short" product line with fewer options because products are easier to produce.

Once the product line has been determined, each distinct product within the product line must be designed. **Product design** is the process of creating a set

Figure 8-3 Planning for Production

Once research and development identifies an idea that meets customer needs, three additional steps are used to convert the idea to an actual good or service.


Research and development identifies an idea for a new good or service.
1
Design planning develops a plan to convert the idea into a new good or service.
2
Facilities planning identifies a site where the good or service can be produced.
3
Operational planning decides on the amount of goods or services that will be produced within a specific time period.

design planning the development of a plan for converting an idea into an actual product or service

product line a group of similar products that differ only in relatively minor characteristics

product design the process of creating a set of specifications from which a product can be produced of specifications from which a product can be produced. For example, product engineers for Samsung must make sure that their new "Family Hub" refrigerator keeps food frozen in the freezer compartment. At the same time, they must make sure that lettuce and tomatoes do not freeze in the crisper section of the refrigerator. The need for a complete product design is fairly obvious; products that work cannot be manufactured without it. But services should be designed carefully as well—and *for the same reason.*

SAMSUNG
SAMSUNG
Touch screen to explore

ERIC GLENN/SHUTTERSTOCK.COM

Appliances have come a long way since they were first created. Would you believe the first "ice boxes" had a compartment to store ice to keep food cool? Eventually, refrigerators, stoves, and washing machines evolved and now are more energy efficient and provide new features like the ones pictured in this photo. Today's successful companies, like Samsung, use a design planning process to create state-of-the-art appliances to make sure their products meet exacting specifications.

Production Capacity **Capacity** is the number of products or services that an organization can produce in a given period of time. Consider the impact of the COVID-19 pandemic on the Clorox Company. Clorox experienced increased demand for bleach and disinfecting wipes during the pandemic. To make matters worse, customers often found empty shelves in grocery stores, big discount stores, and drug stores. Online retailers including Amazon also had to delay shipments of Clorox's products. To meet demand, Clorox began to increase capacity as quickly as possible. Managers had to make decisions about what products would be made at each production facility, extend the hours each production plant would operate, and determine what else could be done to keep facilities operating at full capacity. Each management decision was made with one goal in mind: Determine the required capacity the firm needs to meet increased demand for Clorox's products.

While Clorox's capacity problems were caused by the pandemic, other firms with increased sales and future plans for expansion must often increase capacity to meet their long-term goals. For example, Mazda and Toyota agreed to share the cost of building a $2.3 billion plant in Huntsville, Alabama. The plant will assemble a Mazda SUV automobile that is new to the North American market. Toyota will produce a new crossover SUV model. Management decisions like the ones made by Clorox, Mazda, and Toyota are driven by the need to increase capacity. This, in turn, determines the size of the production facility or number of production facilities and amount of goods and services that will be produced. If a firm has too much capacity, valuable resources (plant, equipment, and money) will lie idle. If a firm has too little capacity, additional capacity may have to be added later when it is much more expensive than in the initial building stage.

Capacity means about the same thing to service businesses. For example, the capacity of a restaurant such as the Hard Rock Cafe in Nashville, Tennessee, is the number of customers it can serve at one time.

Use of Technology During the design-planning stage, management must determine the degree to which *automation* and *technology* will be used to produce a product or service. Here, there is a trade-off between high initial costs and low operating costs (for automation) and low initial costs and high operating costs (for human labor). Ultimately, management must choose between a labor-intensive technology and a capital-intensive technology. A **labor-intensive technology** is a process in which people must do most of the work. Most construction projects, the Kansas

capacity the number of products or services that an organization can produce in a given time

labor-intensive technology a process in which people must do most of the work

City Chiefs football team, and accounting firms for example, are labor-intensive. A **capital-intensive technology** is a process in which machines and equipment do most of the work. A Sony automated assembly plant is capital intensive because there are fewer workers that operate automated machinery. In many situations, people and technology are combined to create the most efficient and most cost-effective method to produce goods or services.

8-5b Site Selection and Facilities Planning

Generally, a business will choose to produce products in an existing factory as long as (1) the existing facility has enough capacity to handle increased customer demand for established products and services and any new products or services and (2) the cost of refurbishing an existing factory is less than the cost of building a new one.

After exploring the capacity of existing factories, management may decide to build a new facility. In determining where to locate production facilities, management must consider a number of variables, including the following:

- Locations of customers and suppliers;
- Quality of life for employees and management in the proposed location;
- The cost of land and building costs;
- Local and state taxes, environmental regulations, and zoning laws;
- The amount of financial support and subsidies, if any, offered by local and state governments; and
- Special requirements, such as great amounts of energy or water used in the production process.

Before making a final decision about where a proposed plant will be located and how it will be organized, two other factors—human resources and plant layout—should be examined.

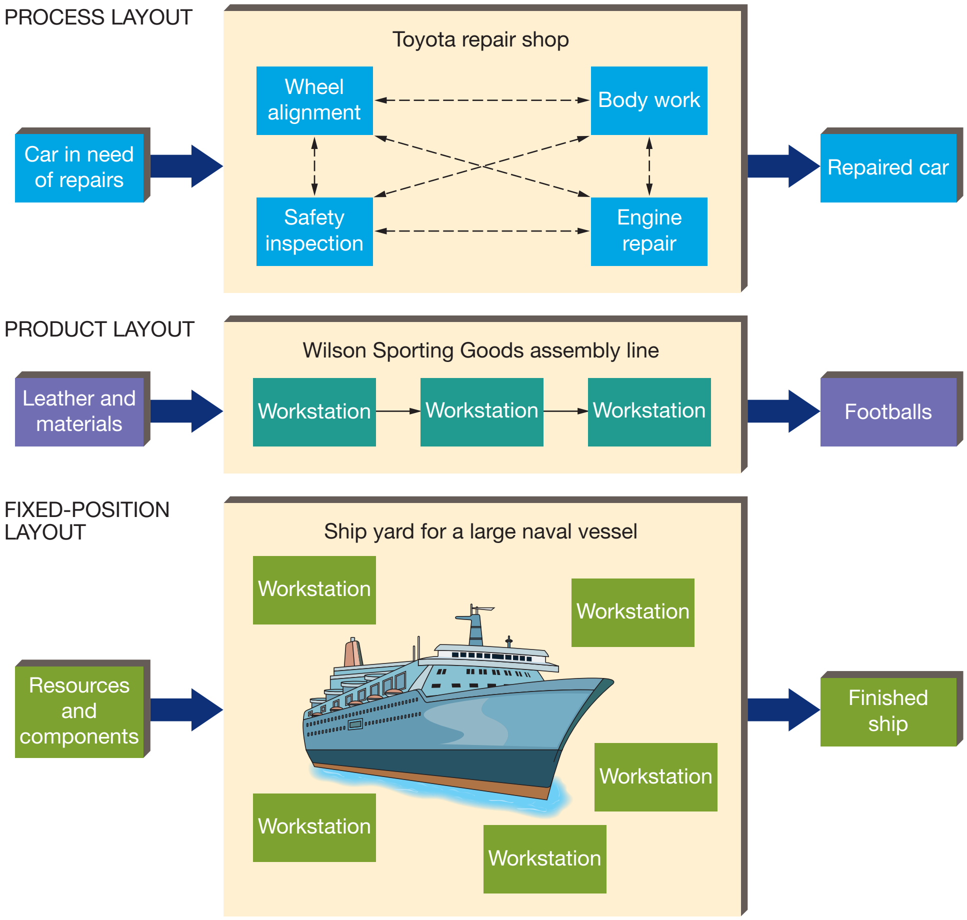
Human Resources When Volvo built its new South Carolina production facility to produce automobiles, human resources managers were involved to make sure the employees needed to staff and operate the plant were available. In some cases, human resources managers must recruit workers, especially when unemployment is low and competition for qualified workers is intense. To increase the number of qualified workers at the South Carolina plant, Volvo management worked with both state and local officials to develop a 62-hour compressed manufacturing educational program that is offered at area technical schools. Upon completion of the 62-hour program, Volvo agreed to waive the one-year of manufacturing experience requirement for new employees.[14]

When a company decides to build a new facility in a foreign country, again human resources managers are involved. For example, suppose a U.S. firm like General Motors wants to lower labor costs by importing component parts from China. It has two choices. It can build its own manufacturing facility in a foreign country or it can outsource production to local firms in that country. In either case, human resources become involved in the decision. If the decision is made to build its own plant, human resources managers will have to recruit employees with the appropriate skills who are willing to relocate to a foreign country, develop training programs for local workers, or both. On the other hand, if the decision is made to outsource production to local suppliers, human resources managers must make sure that local suppliers are complying with the U.S. company's human rights policies and with all applicable national and local wage and hour laws. For General Motors, selecting suppliers in foreign countries is an important consideration. At a recent awards ceremony, General Motors recognized 116 companies representing 15 different countries with its Supplier of the Year award.[15]

capital-intensive technology a process in which machines and equipment do most of the work

Figure 8-4 Facilities Planning

The process layout is used when small batches of different products are created or when working on different parts of a product. The product layout (assembly line) is used when all products undergo the same operations in the same sequence. The fixed-position layout is used in producing a product too large to move.


PROCESS LAYOUT
Toyota repair shop
Car in need of repairs
Wheel alignment
Body work
Safety inspection
Engine repair
Repaired car
PRODUCT LAYOUT
Wilson Sporting Goods assembly line
Leather and materials
Workstation
Workstation
Workstation
Footballs
FIXED-POSITION LAYOUT
Ship yard for a large naval vessel
Resources and components
Workstation
Workstation
Workstation
Workstation
Workstation
Finished ship

Plant Layout **Plant layout** is the arrangement of machinery, equipment, and personnel within a production facility. Three general types of plant layout are used (refer to Figure 8-4).

The *process layout* is used when different operations are required for creating small batches of different products or services. The facility is arranged so that each operation is performed in its own particular area. A hospital provides an example of a process layout. Specific services are located in different parts of the facility. For example, there may be areas for surgery, physical therapy, respiratory therapy, X-rays, a pharmacy, and offices for billing, accounting, insurance, and administration. If you need physical therapy, you only "visit" the department where physical therapy services are provided. Service and repair companies also use the process layout. For example, if you take your Toyota Camry for a wheel alignment, your car "visits" only the area where alignments are performed.

A *product layout* (sometimes referred to as an *assembly line*) is used when all products undergo the same operations in the same sequence. Workstations are arranged to match the sequence of operations, and work flows from station to station. An assembly line is the best example of a product layout. For example, Wilson Sporting Goods uses an assembly line process to create footballs in its Ada, Ohio, plant.

plant layout the arrangement of machinery, equipment, and personnel within a production facility

RICHARDJOHNSON/SHUTTERSTOCK.COM

Too big to move!
Ferguson Marine uses a fixed-position production layout to build both cargo freighters and naval vessels. While ships, like the one in this picture, will eventually sail the oceans of the world, during the production process it's often easier to move people, scaffolding, machinery, and parts instead of moving a large partially completed ship.

A *fixed-position layout* is used when a very large product is produced. Aircraft manufacturers, for instance, use a fixed-layout plant arrangement because of the size of its products—commercial airliners. Shipbuilders also use this type of layout because of the difficulty of moving a large product such as an ocean liner. In both examples, the product remains stationary during production, and people, parts, and equipment are moved as needed to assemble the product.

8-5c **Operational Planning**

The objective of operational planning is to decide on the number of products or services each facility will produce during a specific period of time. Four steps are required.

Step 1: Selecting a Planning Horizon A **planning horizon** is simply the time period during which an operational plan will be in effect. A common planning horizon for production plans is one year. Then, before each year is up, management must plan for the next. A planning horizon of one year generally is long enough to average out seasonal increases and decreases in sales. At the same time, it is short enough for planners to adjust production to accommodate long-range sales trends.

Step 2: Estimating Market Demand The *market demand* for a product is the quantity that customers will purchase at the going price. Sales projections developed by marketing managers are the basis for market-demand estimates.

Step 3: Comparing Market Demand with Capacity The third step in operational planning is to compare the estimated market (customer) demand with the facility's capacity to produce products or services to satisfy that demand. One of three outcomes may result: Demand may exceed capacity, capacity may exceed demand, or capacity and demand may be equal. If they are equal, the facility should be operated at full capacity. However, if market demand and capacity are not equal, adjustments may be necessary.

Step 4: Adjusting Production to Meet Demand The biggest reason for changes to a firm's production schedule is changes in market (customer) demand for its products. For example, Indiana-based Berry Global Corporation produces packaging and tape and adhesive products. One particularly successful product line for Berry Global is drink cups that can be screen-printed to promote a company

planning horizon the time period during which an operational plan will be in effect or its products or services.[16] If Berry Global obtains a large contract to provide promotional cups to a large drink distributor like Coca-Cola or Pepsi, the company may need to work three shifts a day, seven days a week, until the contract is fulfilled. Unfortunately, the reverse is also true. If the company's sales force does not generate new sales, there may be only enough work for the employees on one shift.

When market (customer) demand exceeds capacity, several options are available. Production of products or services may be increased by operating the facility overtime with existing personnel or by starting a second or third work shift. For manufacturers, another response is to subcontract or outsource a portion of the work to other manufacturers. If the excess demand is likely to be permanent, the firm may expand the current facility or build another facility.

What happens when capacity exceeds market (customer) demand? Again, there are several options. To reduce output temporarily, workers may be laid off or the facility may be operated on a shorter-than-normal workweek. To adjust to a permanently decreased demand, management may shift the excess capacity of a manufacturing facility to the production of other goods or services. The most radical adjustment is to eliminate the excess capacity by selling unused manufacturing facilities.

✓ Concept Check

- What are the major elements of design planning?
- Define capacity. Why is it important for a manufacturing business or a service business?
- What factors should be considered when selecting a site for a new manufacturing facility?
- What is the objective of operational planning? What four steps are used to accomplish this objective?

8-6 Operations Control

Learning Objective

8-6 Explain how purchasing, inventory control, scheduling, and quality control affect production.

We have discussed the development of an idea for a product or service and the research and development and planning that translate that idea into the reality. Now we are ready to begin the production process. In this section, we examine four important areas of operations control: purchasing, inventory control, scheduling, and quality control (refer to Figure 8-5).

8-6a Purchasing

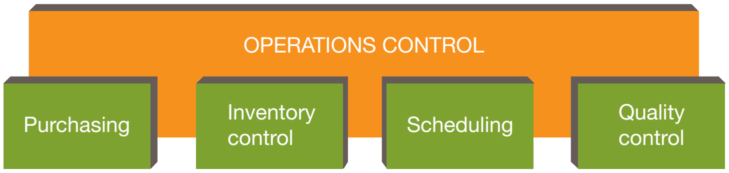
Purchasing consists of all the activities involved in obtaining required materials, supplies, components (or subassemblies), and parts from other firms. Levi Strauss, for example, must purchase denim cloth, thread, and zippers before it can produce a single pair of jeans.

The objective of purchasing is to ensure that required materials are available when they are needed, in the proper amounts, and at minimum cost. Generally, the company with purchasing needs and its suppliers must develop a working relationship built on trust and reliability. In addition, many companies believe that purchasing is one area where they can promote diversity and inclusion. For example, AT&T developed a Supplier Diversity Program in 1968. Today, goals for the AT&T program include purchasing a total of 21.5 percent of all products and services from businesses owned by certified minority women, people who identify as LGBTQ+, veterans, and people with disabilities. In recent years, it

purchasing all the activities involved in obtaining required materials, supplies, components, and parts from other firms

Figure 8-5 Four Aspects of Operations Control

Implementing the operations control system in any business requires the effective use of purchasing, inventory control, scheduling, and quality control.



has exceeded the goal of 21.5 percent and each year purchases approximately $14 billion in merchandise and supplies from diverse businesses that obtain AT&T supplier certification.[17]

Purchasing personnel should constantly be on the lookout for new or backup suppliers, even when their needs are being met by their present suppliers, because problems such as worker strikes, equipment breakdowns, or nonessential business closures during a pandemic can cut off the flow of purchased materials from a primary supplier. Many of the product shortages that occurred during the COVID-19 pandemic were caused because manufacturers couldn't obtain needed resources from suppliers to produce products. In many cases, the inability to get resources broke the supply chain—suppliers to manufacturers to wholesalers or retailers to customers.

The choice of suppliers should result from careful analysis of a number of factors. The following are especially critical:

- *Price*. Comparing prices offered by different suppliers is always an essential part of selecting a supplier.
- *Quality*. Purchasing specialists always try to buy materials at a level of quality in keeping with the type of product being manufactured. The lowest acceptable quality is usually specified by product designers.
- *Reliability*. An agreement to purchase high-quality materials at a low price is the purchaser's dream. However, the dream becomes a nightmare if the supplier does not deliver.
- *Shipping costs*. The question of who pays the shipping costs should be answered before any supplier is chosen.

BONANDBON/SHUTTERSTOCK.COM

Gorgeous inventory! Every spring nurseries and garden centers must increase their inventory of flowering plants, shrubs, and trees that customers purchase to spruce up their yards for late spring and summer. In many cases, the supply chain for these same items includes growers, wholesalers, and retailers—different types of businesses that must maintain inventory to meet the needs of the next customer in the supply chain.

8-6b Inventory Control

Can you imagine what would happen if a Coca-Cola manufacturing plant ran out of the company's familiar red-and-white aluminum cans? It would be impossible to complete the manufacturing process and ship soft drinks to retailers. Management would be forced to shut the assembly line down until the next shipment of cans arrived from a supplier. The simple fact is that shutdowns are expensive because costs such as employee wages, rent, utilities, insurance, and other expenses still must be paid.

Operations managers are concerned with three types of inventories. A *raw-materials inventory* consists of materials that will become part of the product during the production process. The *work-in-process inventory* consists of partially completed products. The *finished-goods inventory* consists of completed goods. Each type of inventory also has a *holding cost,* or storage cost, and a *stock-out cost,* the cost of running out of inventory. **Inventory control** is the process of managing inventories in such a way as to minimize inventory costs, including both holding costs and potential stock-out costs.

Today, computer systems are being used to track all three types of inventory and alert managers to impending stock-outs. One of the most sophisticated methods of inventory control used today is material requirements planning. **Material requirements planning (MRP)** is a computerized system that integrates production

inventory control the process of managing inventories in such a way as to minimize inventory costs, including both holding costs and potential stock-out costs

material requirements planning (MRP) a computerized system that integrates production planning and inventory control planning and inventory control. An MRP system answers three questions: What is needed; how much is needed; and when is it needed. One of the great advantages of an MRP system is its ability to juggle delivery schedules and lead times effectively. For a complex product such as an automobile with 30,000 or more individual parts, a manager using an MRP system can arrange both order and delivery schedules so that materials, parts, and supplies arrive when they are needed.

Because large firms can incur huge inventory costs, much attention has been devoted to inventory control. The just-in-time system used by some businesses is one result of all this attention. A **just-in-time inventory (JIT) system** is designed to ensure that materials or supplies arrive at a facility just when they are needed so that storage costs are minimized. For example, managers using a just-in-time inventory system at a Harley Davidson assembly plant determine the number of motorcycles that will be assembled in a specified time period. Then Harley Davidson purchasing personnel order just the parts needed to produce those motorcycles. In turn, suppliers deliver the parts in time or when they are needed on the assembly line. The benefits for Harley Davidson are enormous and include decreased inventory levels and a much more efficient manufacturing process that reduces costs and increases profits. While stories of large firms like Harley Davidson, Dell, and Toyota are common, smaller firms can also use JIT to reduce costs and improve profitability.

just-in-time inventory (JIT) system a system designed to ensure that materials or supplies arrive at a facility just when they are needed so that storage costs are minimized

scheduling the process of ensuring that materials and other resources are at the right place at the right time

8-6c Scheduling

Scheduling is the process of ensuring that materials and other resources are at the right place at the right time. As our definition implies, both place and time are important to scheduling. The *routing* of materials is the sequence of workstations that the materials will follow. Assume that Hickory White—a furniture company based in

Technology and Innovation

Walmart Puts Inventory-Tracking Robots on the Curb

Walmart, the largest retailer in the world, ditched a multi-year, multi-million-dollar plan to introduce automated inventory-scanning robots in its stores after discovering humans achieve similar results. The move ended a contract with start-up Bossa Nova Robotics after a five-year relationship. Initially, Walmart said the Bossa Nova robots would be used in about 20 percent of its domestic stores as part of a greater push for automation.

Walmart used the machines in an effort to reduce labor costs and increase sales by reducing out-of-stock items. After testing the robots in 500 stores, however, the retailer found that humans proved to be just as, if not more, capable and effective at keeping tabs on inventory levels. As more and more consumers place orders online and then pick up merchandise at stores or ship merchandise to their homes, maintaining accurate inventory records and the actual merchandise in stores or warehouses has become increasingly important. Today, consumers expect a seamless shopping experience, and they have become spoiled by the ability to get merchandise without having to wait. This expectation makes inventory control more important than it has ever been.

With the six-foot-tall robots out of the picture, the company is entrusting the job of inventory control once again to human employees. Industry experts project that automation will lead to millions of lost jobs, so this marks Walmart's decision as a victory for human workers. And yet, Walmart is still using automation and robots for some work in its stores including autonomous floor scrubbers. The big-box retailer is also exploring new ways to use automation and robots in its warehouses and perform other chores when automation and technology can reduce expenses and improve productivity.

Sources: Based on information in M. Corey Goldman, "Walmart Ditches Robots, Sticks With Humans for Inventory Control," *The Street*, November 3, 2020, www.thestreet.com/investing/walmart-wmt-ditches-robots-sticks-with-humans-nventory-control; Kenneth Garger, "Walmart Fires Inventory-Tracking Robots, Realizes Humans Work Just as Well," *New York Post*, November 2, 2020, www.nypost.com/2020/11/02/walmart-fires-inventory-tracking-robots-will-use-humans-instead; Sarah Nassauer, "Walmart Scraps Plan to Have Robots Scan Shelves," *The Wall Street Journal*, November 2, 2020, www.wsj.com/articles/walmart-shelves-plan-to-have-robots-scan-shelves-11604345341.

North Carolina—is scheduling production of an oval dining table made from cherry wood. Operations managers route the needed materials (wood, screws, packaging materials, etc.) through a series of individual workstations along an assembly line. At each workstation, a specific task is performed, and then the partially finished dining table moves to the next workstation. When routing materials, operations managers are especially concerned with the sequence of each step of the production process. For the dining table, the top and legs must be cut before the wood is finished. (If the wood were finished before being cut, the finish would be ruined, and the dining table would have to be stained again.)

When scheduling production, managers are also concerned with timing. The *timing* function specifies when the materials will arrive at each station and how long they will remain there. For the cherry dining table, it may take workers two hours to cut the table top and legs and another hour to drill the holes and assemble the table. Before packaging the dining table for shipment, it must be finished with cherry stain and allowed to dry. This last step may take as long as three days depending on weather conditions and humidity.

Regardless of whether the finished product requires a simple or complex production process, operations managers are responsible for monitoring schedules—called *follow-up*—to ensure that the work flows according to the schedule.

Malcolm Baldrige National Quality Award an award given by the president of the United States to organizations judged to be outstanding in specific managerial tasks that lead to improved quality for both products and services

quality control the process of ensuring that goods and services are produced in accordance with design specifications

8-6d Quality Control

As mentioned earlier in this chapter, American business firms that compete in the competitive global marketplace have taken another look at the importance of improving quality. Today, there is even a national quality award. The **Malcolm Baldrige National Quality Award** is given by the president of the United States to organizations judged to be outstanding in specific managerial tasks that lead to improved quality for both products and services.

Quality control is the process of ensuring that goods and services are produced in accordance with design specifications. Over the years, more and more managers have realized that quality is an essential "ingredient" of the good or service being produced. This view of quality provides several benefits. Making products or completing services right the first time reduces many of the rejects and much of the rework. Also, the number of defects decreases, which causes profits to increase.

The major objective of quality control is to see that the organization lives up to the standards it has set for itself on quality. Some firms, such as Mercedes-Benz and Lexus, have built their reputations on quality. Other firms adopt a strategy of emphasizing lower prices along with reasonable (but not particularly high) quality. Today, many firms use the techniques described in Table 8-1 to gather information and statistics that can be used to improve the quality of a firm's products or services.

COACH
COACH
COACH

CHRIS WORLDWIDE/SHUTTERSTOCK.COM

For a product like a Coach handbag, quality counts. Customers expect that luxury items must meet exacting specifications. After all, customers are paying "top dollar" for items like the handbags in this picture. For a luxury item, employees must inspect the product and any defect or flaw must be caught before the product leaves the company's factory.

Improving Quality Through Employee Participation One of the first steps needed to improve quality is

Table 8-1 Four Widely Used Techniques to Improve the Quality of a Firm's Products

Technique	Description
Benchmarking	A process of comparing the way a firm produces products or services to the methods used by organizations known to be leaders in an industry in order to determine the "best practices" that can be used to improve quality
Continuous Quality Improvement	Continuous improvement is a never-ending effort to eliminate problems and improve quality. Often this method involves many small changes or steps designed to improve the production process on an ongoing basis.
Statistical Process Control (SPC)	Sampling to obtain data that are plotted on control charts and graphs to see if the production process is operating as it should and to pinpoint problem areas
Statistical Quality Control (SQC)	A detailed set of specific statistical techniques used to monitor the production process to determine the acceptability of a product

employee participation. Simply put, successful firms encourage employees to accept full responsibility for the quality of their work. When Toyota, once the role model for world-class manufacturing, faced a quality crisis, the company announced a quality-improvement plan based on its famous "Toyota Way." One tenet of the Toyota Way is the need to solve problems at their source and to stop the production line if necessary to address a problem. Another tenet that enabled Toyota to resolve quality problems was the use of quality circles designated to deal with difficulties as they arise. A **quality circle** is a team of employees who meet on company time to solve problems of product quality. Quality circles have also been used successfully in companies such as IBM, Northrop Grumman Corporation, Lockheed Martin, and General Motors.

Increased effort is also being devoted to **inspection**, which is the examination of the quality of work in process. Employees perform inspections at various times during production. For example, component parts may be inspected before they become part of a finished product. In addition, finished goods may be inspected before they are shipped to customers. Items that are within design specifications continue on their way. Those that are not within design specifications are removed from production.

Total Quality Management and Six Sigma

Total quality management (TQM) is the coordination of efforts directed at improving customer satisfaction, increasing employee participation, strengthening supplier partnerships, and facilitating an organizational atmosphere of continuous quality improvement. Although total quality management (TQM) can be used to improve the quality of a firm's products or services, it also involves other essential activities. For TQM programs to be effective, management must address each of the following components:

- *Customer satisfaction.* Increasing customer satisfaction by producing higher-quality products, providing better customer service, and showing customers that the company cares.
- *Employee participation.* Establishing policies that enable employees to contribute to decisions, develop self-managed work teams, and assume responsibility for improving the quality of products or services.
- *Strengthening supplier partnerships.* Developing good working relationships with suppliers can ensure that the right supplies and materials will be delivered on time at lower costs.
- *Continuous quality improvement.* Creating an organization based on continuous improvement has proven to be the most effective long-term approach.

quality circle a team of employees who meet on company time to solve problems of product quality

inspection the examination of the quality of work-in-process

total quality management (TQM) the coordination of efforts directed at improving customer satisfaction, increasing employee participation, strengthening supplier partnerships, and facilitating an organizational atmosphere of continuous quality improvement

Although many factors influence the effectiveness of a TQM program, two issues are crucial. First, top management must make a strong commitment to a TQM program. Second, management must coordinate the above components of a TQM program so that they work in harmony with each other. Many firms including American Express, AT&T, and Motorola have used TQM to improve product quality and ultimately customer satisfaction.

WRIGHT STUDIO/SHUTTERSTOCK.COM

Another technique that businesses may use to improve not only quality but also overall performance is Six Sigma. **Six Sigma** is a disciplined approach that relies on statistical data and improved methods to eliminate defects for a firm's products and services. Although many experts agree that Six Sigma is similar to TQM, Six Sigma often has more top-level support, much more teamwork, and a new corporate attitude or culture.[18] Today, both large and small companies can use TQM or Six Sigma to improve quality.

World Standards: The International Organization for Standardization

Without a common standard of quality, customers may be at the mercy of manufacturers and suppliers. As the number of companies competing in the global marketplace has increased, so has the seriousness of this problem. To deal with the problem of standardization, the International Organization for Standardization, a nongovernmental organization with headquarters in Geneva, Switzerland, was created. The **International Organization for Standardization (ISO)** is a network of national standards institutes and similar organizations from 165 different countries that is charged with developing standards for quality products and services and environmental standards for global manufacturers and producers.[19]

Standardization is achieved through consensus agreements between national delegations representing all the economic stakeholders—suppliers, customers, and often governments. The member organization for the United States is the American National Standards Institute (ANSI) located in Washington, DC.

Although certification is not a legal requirement to conduct business globally, ISO standards are so prevalent around the globe that many customers refuse to do business with noncertified companies. As an added bonus, companies completing the certification process often discover new, cost-efficient ways to improve their existing quality-control programs.

8-6e Production Planning: A Summary

In this chapter, the activities that firms use to produce products and services have been described. Now, toward the end of the chapter, it may help to look at a table to see how all of the "pieces of the puzzle" fit together. At the top of Table 8-2, planning for production begins with research and development, design planning, site selection and facilities planning, and operational planning—all topics described in this chapter. At the bottom of Table 8-2, activities that were described in the Operations Control section (purchasing, inventory control, scheduling, and quality control) are summarized. The goal of all the planning activities in the top section and operations control activities in the bottom section is to create and produce a successful product or service. Of course, the steps for planning production and operations control should always be evaluated to determine if the firm's activities can be improved.

Six Sigma a disciplined approach that relies on statistical data and improved methods to eliminate defects for a firm's products and services

International Organization for Standardization (ISO) a network of national standards institutes and similar organizations from 165 different countries that is charged with developing standards for quality products and services and environmental standards for global manufacturers and producers

Table 8-2 **Production Planning: A Summary**

Both planning for production and operations control are necessary if a firm is to produce a successful product or service.

The Process Begins with Planning for Production
1. *Research and Development* determines if an idea for a product or service will begin the production process.
2. *Design Planning* develops a plan for producing a product or service.
3. *Site Selection and Facilities Planning* identifies a production site, a plant layout, and if human resources are available.
4. *Operational Planning* decides on the number of products or services that will be produced during a planning horizon, usually one year.
Then Four Operations Control Steps Are Used to Produce a Product or Service
1. *Purchasing* obtains required materials, supplies, parts, and needed resources from other firms.
2. *Inventory Control* ensures that materials, supplies, and parts are available when needed.
3. *Scheduling* ensures that materials and other resources are at the right place and at the right time in the production process.
4. *Quality Control* determines if the firm has lived up to the quality standards it has set for itself.
The End Result: A Successful Product or Service

✓ Concept Check

- Why is selecting a supplier important? What factors should be considered when selecting a supplier?
- What costs must be balanced and minimized through inventory control?
- Explain in what sense scheduling is a control function of operations managers.
- How can a business firm improve the quality of its products or services?

8-7 Improving Productivity with Technology

Learning Objective

8-7 Summarize how technology can make American firms more productive and competitive in the global marketplace.

No coverage of operations management would be complete without a discussion of productivity and technology. Productivity concerns all managers, but it is especially important to operations managers, the people who must oversee the creation of a firm's products or services. In Chapter 1, *productivity* was defined as the average level of output per worker per hour. For example, if each worker at plant A produces 75 units per day and each worker at plant B produces only 70 units per day, the workers at plant A are more productive. If one fast-food employee serves 25 customers per hour and another serves 28 per hour, the second employee is more productive.

8-7a **Productivity Trends**

For U.S. businesses, annual labor productivity growth rates averaged a 1.4 percent increase for the period 2007–2019.[20] More recently, the United States experienced a 2.5 percent increase in labor productivity for 2020.[21] (*Note:* At the time of publication, 2020 was the last year that actual statistics were available.) The statistics for businesses for the four calendar quarters of 2020 resemble a roller coaster ride with a slight increase in the first quarter, a huge decline in the second quarter caused by the COVID-19 pandemic, and increases in the third and fourth quarters.[22] Fortunately, as illustrated in Figure 8-6, the U.S. labor productivity growth rate has been positive every year since 1987. Unfortunately, the average growth rate has slowed for the period beginning in 2007. Based on the decline in productivity growth rates, many economists, business leaders, politicians, and government officials are quick to point out that throughout the nation, manufacturers must find ways to be more productive.

Ethics and Social Responsibility

What It Takes to Be an Ethical Manufacturer

Ethical practices can be a core part of a manufacturing business. Companies that engage in this holistic approach to the manufacturing process, including the equitable treatment of employees and sustainable production of quality products, maintain high ethical standards to better serve all stakeholders.

One of the first benchmarks for an ethical manufacturer is the safe and equitable treatment of employees. While many safety measures are mandated by law, an ethical manufacturer goes above and beyond these requirements, never sacrificing safety for productivity. For example, Clorox, known for its namesake bleach and other consumer products, has a reputation as a company that values employees. Additionally, these organizations provide equal opportunities and fair treatment for all employees regardless of race, gender, religion, sexual orientation, ethnicity, nationality, socioeconomic status, language, abilities, age, or political beliefs.

A second benchmark for an ethical manufacturer is sustainability and concern for the environment. All production activities should be energy efficient while minimizing waste and emissions. To achieve these goals, ethical manufacturers often use alternative technologies to reduce waste of materials and natural resources. Optional certification programs exist as a form of self-regulation. For instance, in the textile industry, a Swiss group called Bluesign has established strict criteria to help textile manufacturers monitor the effect their production activities have on sustainability and the environment.

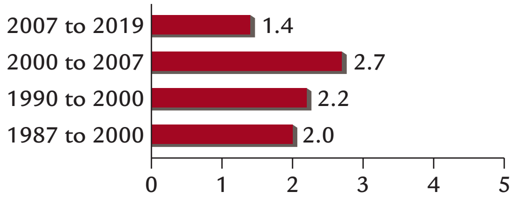
A final benchmark for ethical manufacturers is the product. At the end of the production process, ethical manufacturers provide quality products that are both safe and legal. Ethical manufacturers will often issue voluntary product recalls when safety issues are discovered after a product is sold in the marketplace. Mercedes-Benz, for example, recalled more than one million cars when it discovered an emergency call system glitch had the potential to incorrectly identify a driver's location. Product recalls like this one can be costly and damaging to a firm's reputation, but exemplify the right action that should be taken when a problem is discovered.

Ethical manufacturing is good business. Many consumers will buy from ethical manufacturers because of the way they treat their employees, their efforts to sustain the planet, and their reputation of producing quality products and services. Simply put, when consumers buy products from ethical manufacturers, they can rest easy knowing they purchased a safe item that was sustainably produced. This sense of trust fosters long-term customer relationships.

Sources: Laura Putre, "Employees Choice: The 10 Best Manufacturers to Work For," *Industry Week*, February 16, 2021, https://www.industryweek.com/talent/media-gallery/22013727/employees-choice-the-10-best-manufacturers-to-work-for/slideshow?slide=11; The Bluesign website, www.bluesign.com/en; Kim Lyons, "Mercedes Recalling More Than 1 Million Vehicles Over Emergency-Call Location Error," *The Verge*, www.theverge.com/2021/2/13/22282135/mercedes-recall-1-million-vehicles-emergency-call-location-error; "What Is Ethical Manufacturing?" *Kangovou*, , March 20, 2017, www.kangovou.com/ethical-manufacturing.

Figure 8-6 **U.S. Productivity Growth Rates**

This chart describes labor productivity growth rates for U.S. businesses for the period 1987 to 2019—the latest statistics available prior to publication.



Source: Based on information in "Multifactor Productivity Trends, 2020," the Bureau of Labor Statistics website at www.bls.gov (accessed March 23, 2021).

8-7b Improving Productivity Growth

Many U.S. firms are using a number of techniques to improve productivity. For example, a large number of business firms are adopting lean manufacturing to improve productivity. **Lean manufacturing** is a concept built on the idea of eliminating waste from all of the activities required to produce a product or service. Benefits of lean manufacturing include a reduction in the amount of resources required to produce a product or service, more efficient use of employee time, improved quality, and increased profits. Intel, for example, uses lean manufacturing to improve the quality of new advanced microchips. At the same time, the chip maker is able to reduce waste and defects and increase customer satisfaction. In addition to lean manufacturing, several other factors must be considered if U.S. firms are going to increase productivity *and* their ability to compete in the global marketplace. For example:

- The United States must stabilize its economy so firms will invest more money in new facilities, equipment, technology, and employee training.
- There must be more emphasis on satisfying the customer's needs and increasing customer satisfaction.
- Managers and executives must cooperate with employees to increase employee motivation and participation in the workplace.
- Businesses must examine the existing work flow in their manufacturing facilities and find ways to decrease waste and increase efficiency in the workplace.
- All government policies must be examined to ensure that unreasonable regulations that may be hindering productivity growth are eliminated.
- Increased use of automation, robotics, and computer manufacturing systems must be used to lower production costs and increase profits.

Finally, innovation and research and development efforts to create new products and services must be increased in order for U.S. firms to compete in the global marketplace. Although U.S. manufacturers spend more on research and development (R&D) than those in any other country, manufacturers' spending for R&D is increasing more rapidly in China and other countries.[23] Maintaining or increasing our level of R&D spending is essential if we are to remain competitive in the global market place.

8-7c The Impact of Automation, Robotics, and Computers on Productivity

Automation is the total or near-total use of machines to do work. The rapid increase in automated procedures has been made possible by computer technology used in robotics and in sophisticated manufacturing systems.

Robotics **Robotics** is the creation and application of programmable machines to perform a variety of tasks by manipulating materials and tools. A recent report from PricewaterhouseCoopers (PwC) found that 59 percent of companies in the manufacturing industry are presently utilizing at least one type of production robot.[24] Robots work quickly, accurately, and steadily. Robots are especially effective in tedious, repetitive assembly-line jobs, handling heavy components or tools, working with hazardous materials, or when companies have two or three work shifts. Lincoln Electric, for example, produces robotic welders that eliminate the hot, dirty job of welding, which is key to many manufacturing tasks. As an added bonus, robotic welders are often quicker and are more precise than old-fashioned welding machines. Robots are also useful as artificial "eyes" that can inspect the quality of products as they are being processed on assembly lines or finished products before they are shipped to customers.

To date, the automotive industry has made the most extensive use of robotics, but robots also have been used to mine coal, inspect the inner surfaces of pipes, assemble computer components, clean and guard buildings at night, and even

lean manufacturing a concept built on the idea of eliminating waste from all of the activities required to produce a product or service

automation the total or near-total use of machines to do work

robotics the creation and application of programmable machines to perform a variety of tasks by manipulating materials and tools explore outer space. And robots coupled with artificial intelligence (AI) are now used to perform diagnostic procedures, provide certain kinds of patient care in hospitals, and assist doctors with robotic surgeries.

SUWIN/SHUTTERSTOCK.COM

Is the robot talking to this worker or is the worker talking to the robot? It's hard to tell from the photo, but the worker is actually using a laptop computer to control a robotic arm. According to a recent PricewaterhouseCoopers (PwC) survey, 59 percent of companies in the manufacturing industry are presently utilizing at least one type of production robot to increase productivity on their assembly lines.

Computer Manufacturing Systems People are quick to point out how computers have changed their everyday lives, but most people do not realize the impact computers have had on manufacturing. In simple terms, the factory of the future has already arrived. For most manufacturers, the changeover began with the use of computer-aided design and computer-aided manufacturing. **Computer-aided design (CAD)** is the use of computers to aid in the development of products. Ford speeds up car design, Boeing designs new aircraft, and CafePress, Inc. allows you to use CAD to create custom T-shirts, drinkware, home décor, and personalized greeting cards.

Computer-aided manufacturing (CAM) is the use of software and computers to plan and control manufacturing processes. A well-designed CAM system allows manufacturers to become much more productive. Not only are a greater number of products produced, but speed and quality also increase. Using CAM systems, Toyota produces automobiles and Apple Computer creates electronic products.

If you are thinking that the next logical step is to combine the CAD and CAM computer systems, you are right. Today, the most successful manufacturers use CAD and CAM together to form a computer-integrated manufacturing system. Specifically, **computer-integrated manufacturing (CIM)** is a computer system that not only helps to design products but also controls the machinery needed to produce the finished product. For example, Sauder Woodworking—North America's leading producer of ready-to-assemble furniture—uses CIM to plan and control production of more than 40 different furniture collections for the home, including products for the home office, bedroom, kitchen, and storage.[25] Other advantages of using CIM include improved flexibility, more efficient scheduling, and higher product quality—all factors that make a production facility more competitive in today's global economy.

Flexible Manufacturing Systems Manufacturers have known for a number of years that the mass-production and traditional assembly lines used to manufacture products present a number of problems. For example, although traditional assembly lines at General Motors, Ford, Nissan, and other automobile manufacturers turn out extremely large numbers of products economically, the system requires expensive, time-consuming retooling of equipment whenever a new product is to be manufactured. This type of manufacturing is often referred to as a continuous process. **Continuous process** is a manufacturing process in which a firm produces the same product(s) over a long period of time. Now it is possible to use flexible manufacturing systems to solve such problems. A **flexible manufacturing system (FMS)** combines electronic machines and computer-integrated manufacturing in a single production system that can easily adapt to changes in the type of product being produced. Instead of having to spend large amounts of time and effort to retool the traditional mechanical equipment on an assembly line for each new product, an FMS is rearranged simply by reprogramming electronic machines. Because FMSs

computer-aided design (CAD) the use of computers to aid in the development of products

computer-aided manufacturing (CAM) the use of software and computers to plan and control manufacturing processes

computer-integrated manufacturing (CIM) a computer system that not only helps to design products but also controls the machinery needed to produce the finished product

continuous process a manufacturing process in which a firm produces the same product(s) over a long period of time

flexible manufacturing system (FMS) a production system that combines electronic machines and computer-integrated manufacturing that can easily adapt to changes in the type of product being produced require less time and expense to reprogram than traditional systems, manufacturers can produce smaller batches of a variety of products without raising the production cost. Flexible manufacturing is sometimes referred to as an intermittent process. An **intermittent process** is a manufacturing process in which a firm's manufacturing machines and equipment are changed to produce different products.

For most manufacturers, the driving force behind FMSs is the customer. In fact, the terms *customer-driven production* or *make to order system* are often used to describe a manufacturing system driven by customer needs and what customers want to buy. For example, advanced software and a flexible manufacturing system have enabled Dell Computer to change to a more customer-driven manufacturing process and provide customized computers for its customers. Although the costs of designing and installing an FMS such as this are high, the electronic equipment is used more frequently and efficiently than the machinery on a traditional assembly line.

8-7d Sustainability and Technological Displacement

In Chapter 1, *sustainability* was defined as the ability to create and maintain conditions under which present and future generations can exist in productive harmony, and permit fulfilling the social, economic, and other requirements of future and present generations. While sustainability affects all aspects of a nation, its people, and the economy, the concept is especially important for manufacturers and service providers. Because of the amount of resources required to produce goods and services, these businesses must conserve resources whenever possible. As an added bonus, efforts to reduce waste and sustain the planet can often improve a firm's bottom-line profit amount.

Today, many countries around the globe produce goods and services and compete with U.S. manufacturers. And yet, U.S. producers are known for quality and innovation—especially for products that are more expensive or more complicated to manufacture. As a result, most experts agree that, because U.S. manufacturers will continue to innovate, workers who have manufacturing jobs will be highly skilled and will be able to work with robots, automation, and high-tech computerized manufacturing systems. Many workers will be faced with the choice of retraining to work with new technology or seeking jobs in other sectors of the economy. Those that don't possess high-tech skills will be unemployed. Government, business, and education will also need to cooperate in order to provide the training needed to prepare workers for new roles in an automated workplace.

The next chapter discusses many of the issues caused by technological displacement. In addition, a number of major components of human resources management are described, and we see how managers use various reward systems to boost motivation, productivity, and morale.

✓ Concept Check

- How might productivity be measured in a restaurant? In a department store? In a public school system?
- How can robotics, computer manufacturing systems, and flexible manufacturing systems help a manufacturer to produce products?

intermittent process a manufacturing process in which a firm's manufacturing machines and equipment are changed to produce different products

Summary

8-1 Explain the nature of production.

Operations management consists of all the activities that managers engage in to create goods and services. Today, U.S. companies are forced to compete in an ever-smaller world to meet the needs of more-demanding customers. As a result, U.S. manufacturers have used innovation and technology to increase their ability to compete in the global market. Because of innovation, fewer workers are needed, but those workers who are needed must possess the skills to use automation and technology. In an attempt to regain a competitive edge, manufacturers also have taken another look at the importance of improving quality and meeting the needs of their customers. They also have used new techniques to motivate employees, reduced costs, used robotics and computer-aided and flexible manufacturing systems, improved control procedures, and used green manufacturing. Competing in the global economy is not only profitable but also an essential activity that requires the cooperation of everyone within an organization. A number of career options are available for employees in operations management.

8-2 Outline how the conversion process transforms raw materials, labor, and other resources into finished goods or services.

A business transforms resources into goods and services in order to provide utility to customers. Utility is the ability of a good or service to satisfy a human need. Form utility is created by people converting raw materials, finances, and information into finished products or services. Conversion processes vary in terms of the major resources used to produce goods and services (focus), the degree to which resources are changed (magnitude of change), and the number of production processes that a business uses.

8-3 Discuss the importance of service businesses to consumers, other business firms, and the nation's economy.

The application of the basic principles of operations management to the production of services has coincided with the growth and importance of service businesses in the United States. Today 86 percent of American workers are employed in the service industry. In fact, the American economy is now characterized as a service economy. For a service firm, planning often begins with determining who the customer is and what needs the customer has. After customer needs are identified, the next step is to develop a plan that will enable the firm to deliver the services that their customers want or need.

Although it is often more difficult to measure customer satisfaction, today's successful service firms work hard at providing the services customers want. For example, compared with manufacturers, service firms often listen more carefully to customers and respond more quickly to the market's changing needs.

8-4 Describe how research and development leads to new products and services.

Operations management often begins with product research and development and is commonly referred to as R&D. The results of R&D may be entirely new products or services or extensions and refinements of existing products or services. R&D activities are classified as basic research (aimed at uncovering new knowledge), applied research (discovering new knowledge with some potential use), and development and implementation (using new or existing knowledge to produce goods and services). If a firm sells only one product or provides only one service, when customers quit buying the product or service, the firm will die. To stay in business, the firm must, at the very least, find ways to refine or extend the want-satisfying capability of its product or service.

8-5 Discuss the components involved in planning the production process.

Planning for production involves three major phases: design planning, site selection and facilities planning, and operational planning. First, design planning is undertaken to address questions related to the product line, required production capacity, and the use of technology. Then production facilities, human resources, and plant layout must be considered. Operational planning focuses on the use of production facilities and resources. The steps for operational planning include: (1) selecting a planning horizon, (2) estimating market demand, (3) comparing market demand with capacity, and (4) adjusting production of products or services to meet demand.

8-6 Explain how purchasing, inventory control, scheduling, and quality control affect production.

The major areas of operations control are purchasing, inventory control, scheduling, and quality control. Purchasing involves selecting suppliers. The choice of suppliers should result from careful analysis of a number of factors, including price, quality, reliability, and shipping costs. Inventory control is the management of stocks of raw materials, work in process, and finished goods to minimize the total inventory cost. Scheduling ensures that materials and other resources are at the right place at the right time. Quality control guarantees that products and services are produced in accordance with design specifications. The major objective of quality control is to see that the organization lives up to the standards it has set for itself on quality. A number of different activities including quality circles, inspection, total quality management, and Six Sigma can be used to encourage employee participation and to improve quality.

8-7 Summarize how technology can make American firms more productive and competitive in the global marketplace.

Productivity is the average level of output per worker per hour. From 2007 to 2019, U.S. annual labor productivity growth averaged a 1.4 percent increase. More recently, productivity in 2020 increased 2.5 percent. Today, many economists, business leaders, and government officials are quick to point out that, throughout the nation, our manufacturers must find ways to be more productive. Several factors must be considered if U.S. firms are going to increase productivity and their ability to compete in the global marketplace.

Automation, the total or near-total use of machines to do work, has for some years been changing the way work is done in factories. A growing number of industries are using programmable machines called robots. Computer-aided design, computer-aided manufacturing, and computer-integrated manufacturing use computers to help design and manufacture products. A flexible manufacturing system (FMS) combines electronic machines and computer-integrated manufacturing to produce smaller batches of products more efficiently than on the traditional assembly line. Instead of having to spend vast amounts of time and effort to retool the traditional mechanical equipment on an assembly line for each new product, an FMS is rearranged simply by reprogramming electronic machines. An FMS is sometimes referred to as an intermittent process.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

operations management (212)
reshoring (214)
mass production (214)
analytical process (214)
synthetic process (215)
utility (216)
form utility (216)
service economy (217)
research and development (R&D) (219)
design planning (221)
product line (221)
product design (221)
capacity (222)
labor-intensive technology (222)
capital-intensive technology (223)
plant layout (224)
planning horizon (225)
purchasing (226)
inventory control (227)
material requirements planning (MRP) (227)
just-in-time inventory (JIT) system (228)
scheduling (228)
Malcolm Baldrige National Quality Award (229)
quality control (229)
quality circle (230)
inspection (230)
total quality management (TQM) (230)
Six Sigma (231)
International Organization for Standardization (ISO) (231)
lean manufacturing (234)
automation (234)
robotics (234)
computer-aided design (CAD) (235)
computer-aided manufacturing (CAM) (235)
computer-integrated manufacturing (CIM) (235)
continuous process (235)
flexible manufacturing system (FMS) (235)
intermittent process (236)

Discussion Questions

1. Why would Rubbermaid—a successful U.S. company—need to expand and sell its products to customers in foreign countries?
2. What steps have U.S. firms taken to regain a competitive edge in the global marketplace?
3. Do certain kinds of firms need to stress particular areas of operations management? Explain.
4. Is it really necessary for service firms to engage in research and development? In planning for production and operations control?
5. How are the four areas of operations control interrelated?
6. Is operations management relevant to nonbusiness organizations such as colleges and hospitals? Why or why not?

Case 8

Toyota Drives Change in Manufacturing

Toyota is one of the world's largest automobile companies, but it faced a long road to get to this place in history. It wasn't until the company developed its original manufacturing philosophy, the Toyota Production System (TPS), that the carmaker began to thrive. This lean manufacturing approach combined with a culture built on continuously working to improve quality propelled the company to the front of the pack.

Kiichiro Toyoda founded the motor company in 1937 just two years before World War II. After the war, resources including steel and other metals were in low supply. These shortages often forced the company to modify both the product and its production process. For example, Toyota removed one of the headlamps from its Model K truck because of limited amounts of this important component. During this time, Toyota cars were low-cost vehicles with few options or accessories common in today's automobiles.

Toyota's production system, often referred to as just TPS in the automotive world, wasn't conceived until the late 1940s. The company envied the way Ford produced cars in its River Rouge plant in Michigan. One of the main differences between the two companies was that Ford stockpiled large inventories of resources and component parts for future production needs. At the time, Toyota could not afford to have so much inventory on-hand tying up its capital. Instead, Toyota began to look for ways to work around this problem. After studying the methods that American supermarkets used to control inventory, Toyota began to craft a solution based on the concepts of ordering fewer parts, but ordering more often. Using inventory practices common in U.S. supermarkets, Toyota ordered or made only enough parts to replace the ones that were used in the previous production phase. This method later became known as the just-in-time (JIT) inventory system. JIT ensures that materials arrive exactly when they are needed in order to reduce storage and holding costs. To support the JIT inventory system, the company also developed a sign-based tracking method called Kanban to track the flow of goods. Today, many experts consider Kanban to be the precursor to modern bar codes used by businesses to track parts and materials in manufacturing facilities.

TPS, JIT, and Kanban weren't Toyota's only innovations. Ford had set the standard for assembly lines, but Toyota saw room for improvement. With Ford's early production techniques, assembly lines moved continuously, which maximized efficiencies of scale but also allowed room for errors that had to be corrected later. Toyota introduced the Andon Cord, a physical rope that employees could pull to stop the assembly line and allowed workers to fix problems on the spot. The fact that employees had the power to stop the manufacturing line led to increased employee motivation to eliminate the same types of mistakes in the future. The result was a dramatic decline in the number of errors and improved quality of finished cars.

Thanks to TPS, JIT, Kanban, and the Andon Cord, Toyota built a reputation for making affordable, quality vehicles. At the same time, they were also able to produce cars quickly. Because of increased productivity, it takes only 1.6 worker-hours to produce a car, much lower than competitors. And as gas prices increased, Toyota's cheap-to-run vehicles became more appealing to U.S. consumers. By 1962, the company had produced one million cars. A decade later, that number grew to ten million.

Today, one of the secrets of Toyota's continued success is its ability to adapt the methods it has used to become one of the largest car manufacturers in order to compete in today's ever-changing business environment. For example, in some cases, it has increased inventory levels for some essential resources like microchips and electronic components needed to produce cars with the latest technological advancements. While stockpiling of some needed parts is not consistent with JIT inventory control, it was a decision that was driven by shortages of some critical parts in the last 15 to 20 years. To combat the problem of shortages, executives and managers also use a contingency planning system called RESCUE (REinforce Supply Chain Under Emergency) to provide information about potential shortages of thousands of parts supplied by a wide range of diversified suppliers. Toyota's agility in managing its inventory is a definite advantage because it prevents costly production slowdowns or temporary plant closures.

Today, Toyota has manufactured more than 250 million vehicles and shows no signs of slowing down. Because Toyota has set the benchmark for others in waste reduction, efficiency, and incremental quality improvement, companies including Caterpillar, Intel, General Motors, and a multitude of others have followed in their footsteps to increase productivity and improve quality.[26]

Discussion Questions

1. Through the years, Toyota has used TPS, JIT, Kanban, and the Andon Cord in its production plants. How have these methods enabled Toyota to improve the quality of its cars and increase the productivity of its workers?
2. Historically, Toyota has used JIT to control inventory costs, but in the last 15 to 20 years, it has begun stockpiling essential parts needed to produce cars. What factors led to this change in inventory control?
3. Today, Toyota is a recognized leader in efforts to improve product quality and increase employee productivity in the automobile industry. Do you think the same methods that Toyota uses to manufacture cars would work in other types of businesses? Explain your answer.

Building Skills for Career Success

1. Social Media Exercise

Starbucks has taken an innovative approach to improving their products and the customer experience in their stores. Their entire purpose is to create a "third place" beyond home and work where people can congregate and socialize (while having a nice cup of coffee). To engage customers, they created a website called My Starbucks Idea (https://ideas.starbucks.com/) that allows customers to post their ideas for new products or improving the customer's experience in the stores.

1. Visit https://ideas.starbucks.com/. Do you have an idea for Starbucks? If so, post it.
2. Do you think this is an effective way to gain customer ideas for new products? Why or why not?
3. Can you think of other ways that corporate executives at Starbucks can gauge customer interest in their products and in-store experience using social media?

2. Building Team Skills

Suppose that you are planning to build a house in the country. It will be a brick, one-story structure of approximately 2,000 square feet, centrally heated and cooled. It will have three bedrooms, two bathrooms, a family room, a dining room, a kitchen with a breakfast nook, a study, a utility room, an entry foyer, a two-car garage, a covered patio, and a fireplace. Appliances will operate on electricity and propane fuel. You have received approval and can be connected to the cooperative water system at any time. Public sewerage services are not available; therefore, you must rely on a septic system. You want to know how long it will take to build the house.

Assignment

1. In a group, identify the major activities involved in the project and sequence them in the proper order.
2. Estimate the time required for each activity.
3. Present your list of activities to the class and ask for comments and suggestions.

3. Researching Different Careers

Because service businesses are now such a dominant part of our economy, job seekers sometimes overlook the employment opportunities available in production. Two positions often found in manufacturing and production are quality-control inspector and purchasing agent.

Assignment

1. Using the *Occupational Outlook Handbook* at your local library or on the internet (https://www.bls.gov/ooh), find the following information for the jobs of quality-control inspector and purchasing agent:
    a. What type of work is involved in these positions?
    b. Job outlook
    c. Pay
    d. How does someone become qualified for these jobs?
2. Look for other production jobs that may interest you and compile the same sort of information about them.
3. Summarize in a two-page report the key things you learned about jobs in production.

Running a Business

Part 3

Graeter's Grows Through Good Management, Organization, and Quality

Graeter's began as a tiny Cincinnati business and now enjoys a national reputation for the quality of its premium ice cream. Once a small local business, today Graeter's has a state-of-the-art factory, ships ice cream and other products across the United States that are sold in major supermarkets, and has an e-commerce site where customers can order merchandise online. All of these production and marketing activities helps Graeter's to generate more than $125 million in sales each year. Even though the company is expanding, it still clings fiercely to its original small-batch production method for making creamy ice cream from fresh ingredients. CEO Richard Graeter emphasizes that profits are important, but "staying true to who you are and investing in your business is what makes sure that your business is going to be here tomorrow." That's why Graeter's still makes all of its ice cream by hand, ensuring that the texture and taste meet its high standards batch after batch, year after year.

More Than a Family Affair

Graeter's top-management team includes the CEO and two additional fourth-generation Graeter family members. Bob Graeter is in charge of operations and quality assurance. Bob is responsible for manufacturing, as well as for developing new products and finding suppliers to provide ingredients such as fresh fruits, cream, eggs, and chocolates. Chip Graeter oversees all of the company's retail operations. Rounding out the management team are a chief operating officer, a vice president of sales and marketing, a vice president of operations, a plant manager, a controller, and consultants that help the company plan for expansion.

"Every major decision, we make on a consensus basis," Richard says, describing the equal partnership among the three family members. "That doesn't mean we don't have a different point of view from time to time, but . . . we learn to see each other's view and discuss, debate, and get down to a decision that all of us support. The other thing that we have learned to do, something that is a little different than our parents' generation [did], is bring in outside people into the . . . executive level of the management team. . . We now work with consultants to help us plan our strategy to look for a new vision, to develop training programs . . . all those systems that big companies have." Even with growth and expansion, executive-level managers still stay in close contact with employees at all levels and don't hesitate to ask for their input when solving problems and making decisions.

Inside the Org Chart

Graeter's formalized its organization structure over the years as it opened more stores and expanded beyond Cincinnati. Today, the store managers report to a group manager, who in turn reports to the vice president of retail operations. Graeter's sets weekly and monthly sales goals for its stores, based on each unit's location and other factors that affect demand. If a store doesn't meet its goals, the group manager acts quickly to find out why and to help the store get back on track. To make sure employees and store managers are providing great customer service, managers "shop" each store every month, checking on quality and service. These management visits are supplemented by two monthly visits from "mystery shoppers" who buy ice cream and other products on different days, observing what employees are doing and taking note of what else is happening in the store. Their written reports give Graeter's top managers another view of the business, this time from the customer's perspective.

At the company's main production facility, employees in each of three shifts are supervised by a shift manager, who reports to the vice president of operations. The first and third shifts are responsible for ice cream production, while the second shift is in charge of cleaning and sanitizing the facility.

What's the Plan?

For a small business like Graeter's, changes often come quickly, and even with robust planning for the future, there are surprises. A while back, the company was constructing its second factory to support the drive for nationwide distribution when an unexpected opportunity arose: to buy out the last franchise company operating Graeter's retail stores and take over its factory as well. The management team jumped at the chance. "A few months ago, our strategy was just operate one plant," says Richard. "Now our strategy is, adapt to the opportunity that came along. Now, the goal is to make the best use of our assets." The newest Graeter's facility, on Regina Graeter Way in Cincinnati, was built with

the capacity to produce as much as 1 million gallons of ice cream per year. Many steps, such as putting lids on packages and moving them into refrigerated storage, are handled by automated equipment. Yet all of the ice cream is still made in small batches and by hand. Experienced technicians wield a paddle to gradually mix in ingredients such as molten chocolate, which have been pasteurized on the premises to comply with government regulations. Once the ice cream reaches the right temperature and texture, another employee hand-packs it into individual packages, which are then automatically capped, stamped with a date code, sealed, and whisked away to be kept cold until being loaded onto trucks for delivery to supermarket customers. Ice cream samples from every shift's output are tested to ensure purity and quality.

As the company explores the possibility of opening Graeter's stores as far away as Los Angeles and New York and selling more ice cream and other products in new markets, the management team is planning carefully and assessing the potential challenges and advantages of coast-to-coast operations.[27]

Questions

1. Based on this case and the two previous Graeter's cases, what are the company's most important strengths? Can you identify any weaknesses that might affect its ability to grow?
2. How would you describe the departmentalization and the organizational structure at Graeter's? Do you think Graeter's is centralized or decentralized, and what are the implications for its plans for growth?
3. The newest Graeter's plant can produce far more ice cream than is needed today. The company also makes ice cream cakes, pies, toppings, and other products at its other plants. What are the implications for Graeter's strategy and for its operational planning?

Building a Business Plan

Part 3

Now you should be ready to provide evidence that you have a management team with the necessary skills and experience to execute your business plan successfully. Only a competent management team can transform your vision into a successful business. You also should be able to describe your manufacturing and operations plans. The three chapters in Part 3 of your textbook, "Understanding the Management Process," "Creating a Flexible Organization," and "Producing Quality Goods and Services," should help you in answering some of the questions in this part of the business plan.

The Management Team Component

The management team component should include the answers to at least the following questions:

3.1. How is your team balanced in technical, conceptual, interpersonal, and other special skills needed in your business?

3.2. What will be your style of leadership?

3.3. How will your company be structured? Include a statement of the philosophy of management and company culture.

3.4. What are the key management positions, compensation, and key policies?

3.5. Include a job description for each management position and specify who will fill that position. *Note:* Prepare an organization chart and provide the resume of each key manager for the appendix.

3.6. What other professionals, such as a lawyer, an insurance agent, a banker, and a certified public accountant, will you need for assistance?

The Manufacturing and Operations Plan Component

If you are in a manufacturing business, now is a good time to describe your manufacturing and operations plans, space requirements, equipment, labor force, inventory control, and purchasing requirements. Even if you are in a service-oriented business, many of these questions still may apply.

The manufacturing and operations plan component should include the answers to at least the following questions:

3.7. What are the advantages and disadvantages of your planned location in terms of:
- Wage rates
- Unionization
- Labor pool
- Proximity to customers and suppliers
- Types of transportation available
- Tax rates
- Utility costs
- Zoning requirements.

3.8. What facilities does your business require? Will you rent, lease, or purchase the facilities? Prepare a floor plan for the appendix.

3.9. Will you make or buy component parts to be assembled into the finished product? Make sure to justify your “make-or-buy” decision.

3.10. Who are your potential subcontractors and suppliers?

3.11. How will you control quality, inventory, and production? How will you measure your progress?

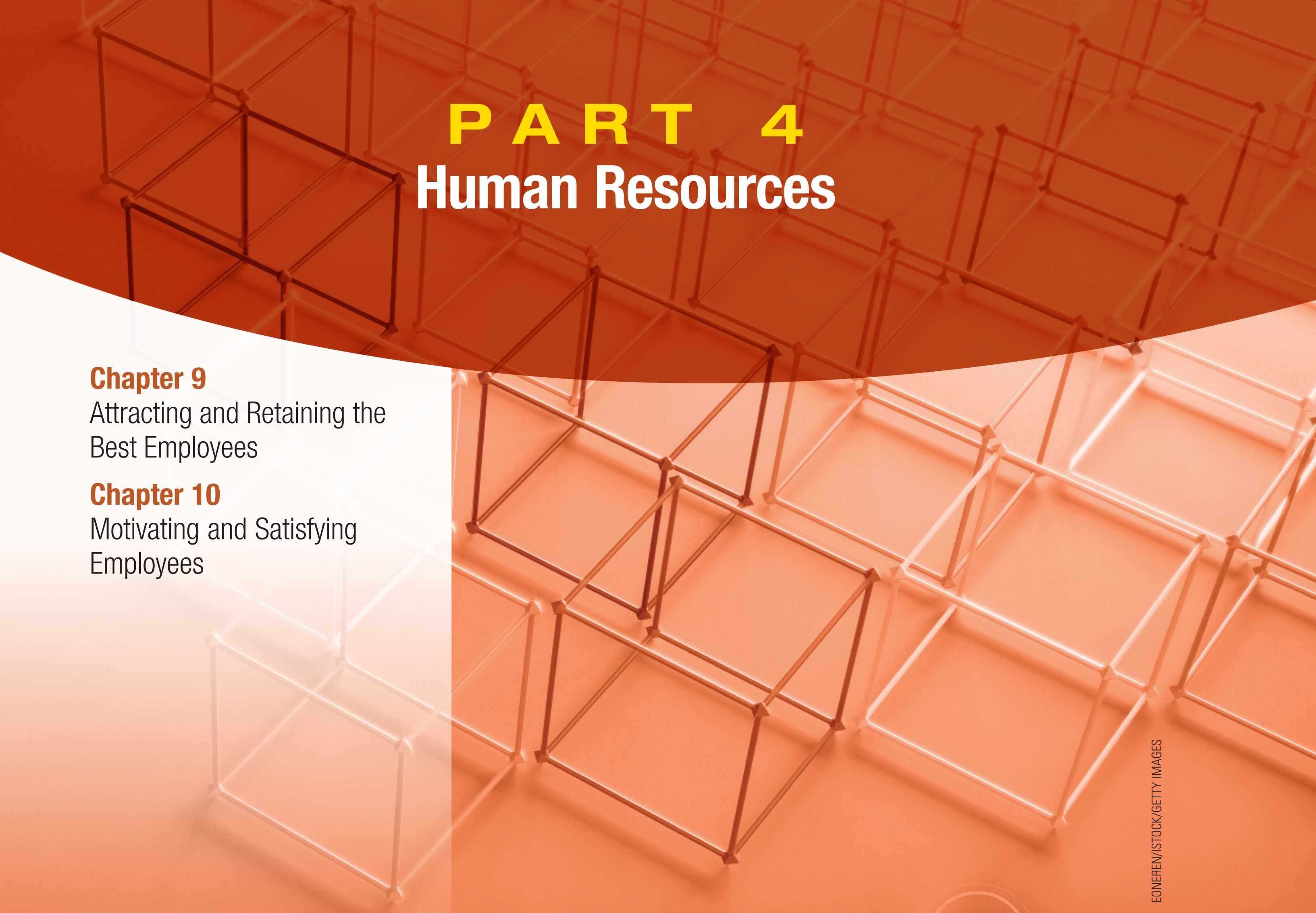
3.12. Is there a sufficient quantity of adequately skilled people in the local labor force to meet your needs?

Review of Business Plan Activities

Be sure to go over the information you have gathered. Check for any weaknesses and resolve them before beginning Part 4. Also, review all the answers to the questions in Parts 1, 2, and 3 to be certain that they are consistent throughout the entire business plan. Finally, write a brief statement that summarizes all the information for this part of the business plan.

PART 4

Human Resources



EONEREN/ISTOCK/GETTY IMAGES

Chapter 9
Attracting and Retaining the Best Employees

Chapter 10
Motivating and Satisfying Employees

IPOPBA/ISTOCK/GETTY IMAGES

This part is concerned with the most important and least predictable of all resources—people. We begin by examining the human resources efforts that organizations use to hire, develop, and retain their best employees. Then we discuss employee motivation and satisfaction.

Chapter

9

ISTOCK.COM/PROSTOCK-STUDIO

Attracting and Retaining the Best Employees

Learning Objectives

Once you complete this chapter, you will be able to:

9-1 Describe the major components of human resources management.

9-2 Identify the steps in human resources planning.

9-3 Discuss workplace diversity and some of the challenges and opportunities associated with it.

9-4 Explain the objectives and uses of job analysis.

9-5 Describe the processes of recruiting, selecting employees, and onboarding.

9-6 Examine decisions associated with employee compensation and benefits.

9-7 Explain the purposes and techniques of employee training and development.

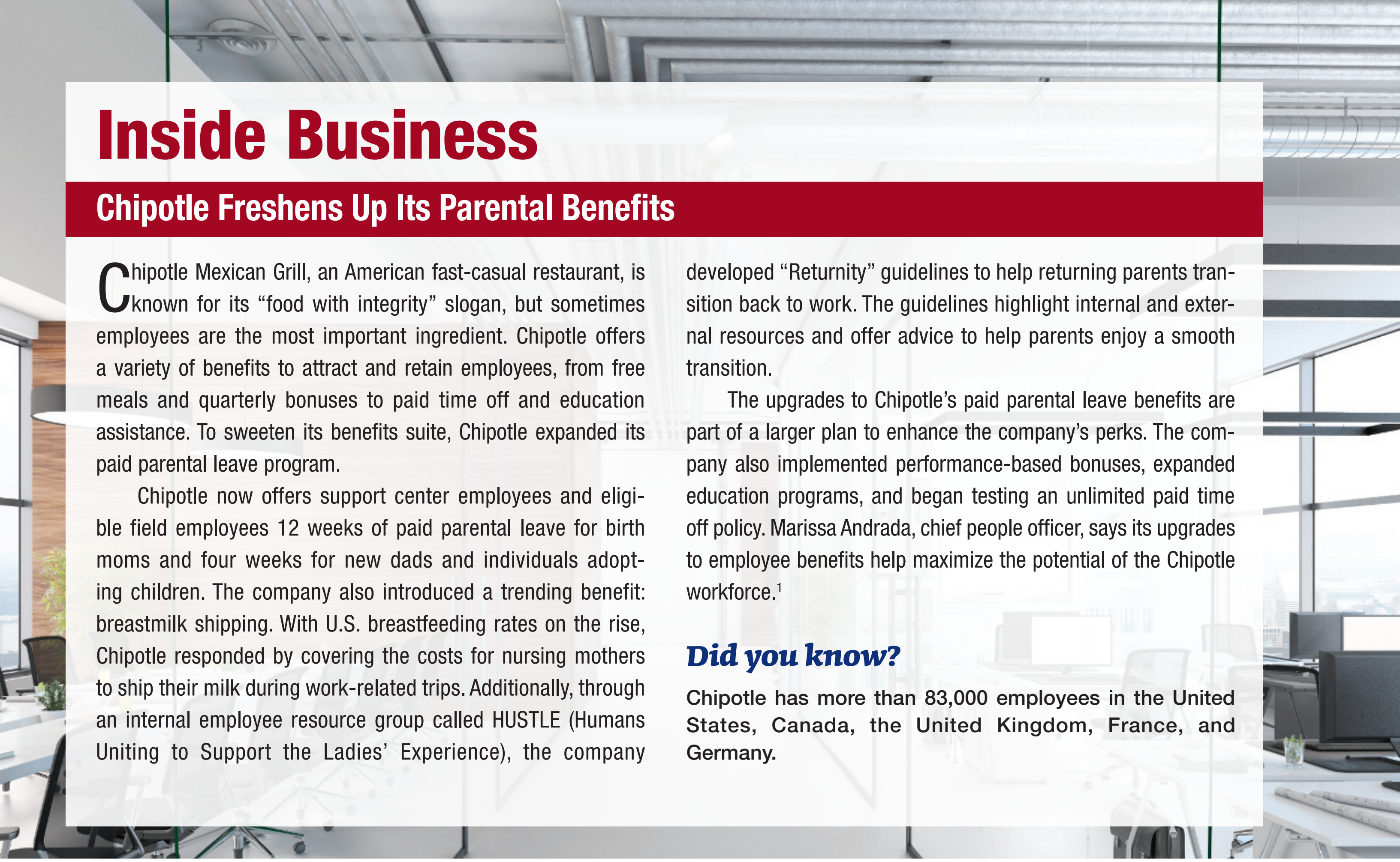
9-8 Discuss performance appraisal techniques and performance feedback.

9-9 List common forms of employee turnover and explain why firms strive to minimize it.

9-10 Explore some of the major legal issues affecting human resources management.

Why Should You Care?

Being able to understand how to attract and keep the right people is crucial. Also, you can better understand your own interactions with your co-workers.



Inside Business

Chipotle Freshens Up Its Parental Benefits

Chipotle Mexican Grill, an American fast-casual restaurant, is known for its "food with integrity" slogan, but sometimes employees are the most important ingredient. Chipotle offers a variety of benefits to attract and retain employees, from free meals and quarterly bonuses to paid time off and education assistance. To sweeten its benefits suite, Chipotle expanded its paid parental leave program.

Chipotle now offers support center employees and eligible field employees 12 weeks of paid parental leave for birth moms and four weeks for new dads and individuals adopting children. The company also introduced a trending benefit: breastmilk shipping. With U.S. breastfeeding rates on the rise, Chipotle responded by covering the costs for nursing mothers to ship their milk during work-related trips. Additionally, through an internal employee resource group called HUSTLE (Humans Uniting to Support the Ladies' Experience), the company developed "Returnity" guidelines to help returning parents transition back to work. The guidelines highlight internal and external resources and offer advice to help parents enjoy a smooth transition.

The upgrades to Chipotle's paid parental leave benefits are part of a larger plan to enhance the company's perks. The company also implemented performance-based bonuses, expanded education programs, and began testing an unlimited paid time off policy. Marissa Andrada, chief people officer, says its upgrades to employee benefits help maximize the potential of the Chipotle workforce.[1]

Did you know?

Chipotle has more than 83,000 employees in the United States, Canada, the United Kingdom, France, and Germany.

Organizations like Chipotle know that human resources, the people who work within an organization, are *the* most important and valuable resource for a business. Without them, a firm would cease to function. For this reason, companies today spend considerable resources to attract, hire, train, and satisfy people who can help them achieve their organizational goals.

We begin our study of human resources management (HRM) with an overview of how businesses attract, retain, and develop human resources. After examining the process by which firms match their human resources needs with the supply available, we explore several dimensions of workplace diversity. Then we examine the concept of job analysis. Next, we focus on how a firm's recruiting, selection, and onboarding procedures affect a firm's success in acquiring employees. We describe forms of employee compensation, which can influence employee loyalty and productivity. Then we discuss methods of employee training, management development, and performance appraisal. We also consider types of employee turnover. Finally, we consider legislation that affects HRM practices.

human resources management (HRM) all the activities involved in acquiring, maintaining, and developing an organization's human resources

9-1 Human Resources Management: An Overview

Learning Objective

9-1 Describe the major components of human resources management.

Organizations spend a great deal of effort to attract and utilize human resources fully. This effort is known as *human resources management*, or *staffing* and *personnel management*. **Human resources management (HRM)** consists of all the activities involved in acquiring, maintaining, and developing an organization's human resources. HRM begins with acquisition—getting people to work for the organization. The acquisition process can be very competitive, particularly for skilled employees and in fields where demand for workers exceeds supply. Next, firms must take steps to retain these valuable resources. (After all, they are the only business resources that can voluntarily leave an organization.) Finally, human resources should be developed to their full capacity.

9-1a **HRM Activities**

Each of the three phases of HRM—acquiring, maintaining, and developing human resources—consists of related actions. Acquisition, for example, includes planning and the various activities that lead to hiring new personnel. Altogether this phase of HRM includes five separate activities:

- *Human resources planning*—determining the firm's future human resources needs
- *Job analysis*—determining the exact nature of the positions
- *Recruiting*—attracting people to apply for positions
- *Selection*—choosing and hiring the most qualified applicants
- *Onboarding*—integrating new employees into the firm

Maintaining human resources consists primarily of striving to satisfy employees and encouraging them to remain with the firm and to work effectively by using a variety of HRM programs, including the following:

- *Employee relations*—increasing employee job satisfaction through satisfaction surveys, employee communication programs, exit interviews, and fair treatment
- *Compensation*—rewarding employee effort through monetary payments
- *Benefits*—providing rewards to ensure employee well-being

The development phase of HRM is concerned with improving employees' skills and expanding their capabilities. The two important activities of this phase are:

- *Training and development*—teaching employees new skills and new jobs, and more effective ways of performing their present jobs
- *Performance appraisal*—assessing employees' current and potential performance levels

We will discuss each of these activities in more detail later in the chapter.

ISTOCK.COM/MANGOSTAR_STUDIO

The power of people. Many firms believe their employees are their most important assets. However, unlike other assets such as machinery, capital, and products, employees can choose to leave an organization. Carefully designing compensation and reward packages can help a firm attract and retain valuable employees.

9-1b **Responsibility for HRM**

In general, HRM is a shared responsibility of line managers and staff HRM specialists. In very small organizations, the owner handles all or most HRM activities. As a firm grows, an owner may employ an outside party to handle some HRM functions, such as payroll and taxes, or hire a human resources manager to take over some staff responsibilities. In very large firms, such as Disney, HRM activities tend to be highly specialized, with separate groups for compensation, benefits, training and development, and other staff activities. GE, for example, has divisions and offices all over the world. Because of the size and complexity of the organization, GE has hundreds of HR managers to cover different geographic areas and departments within the firm.

Specific HRM activities are assigned to those in the best position to perform them. Human resources planning and job analysis are usually carried out by staff specialists with input from line managers. Similarly, staff experts handle recruiting and selection, although line managers are involved in hiring decisions. Staff specialists devise onboarding programs that are carried out by both staff specialists and line managers. Compensation systems (including benefits) most often are developed and administered by the HRM staff. However, line managers recommend pay increases and promotions. Training and development activities are the joint responsibility of staff and line managers. Performance appraisal is the job of the line manager, although HRM personnel design the firm's appraisal system in many organizations.

✓ Concept Check

- What are the three phases of human resources management?
- Identify the activities associated with each phase.
- How does the responsibility of HRM change with the size of a firm?

9-2 Human Resources Planning

Learning Objective

9-2 Identify the steps in human resources planning.

Human resources planning is the development of strategies to meet a firm's future human resources needs. The organization's overall strategic plan is the starting point of the process. From this, human resource planners can forecast future demand for human resources. Next, the planners must determine whether the needed human resources will be available. Finally, they have to take steps to match supply with demand.

9-2a **Forecasting Human Resources Demand**

Planners should base human resources demand forecasts on all relevant information available. The firm's overall strategic plan will provide information about future business ventures, new products, and projected expansions or contractions of specific product lines. Information on past staffing levels, evolving technologies, industry staffing practices, and projected economic trends also can be helpful. Technological advances are creating new opportunities in forecasting and planning for human resources demand. Increasingly, companies are using specialized software to analyze data about their employees' demographics, performance, training, and internal movements in order to make better HR decisions. Insights gained from such technology can help managers develop more cost-effective recruiting and selection strategies as well as recognize threats and opportunities.

HR managers use forecasting information to determine both the number of employees required and their qualifications. Planners use a wide range of methods to predict specific personnel needs. For example, a simple method projects personnel requirements to increase or decrease in the same proportion as sales revenue. Thus, a 30 percent increase in projected sales volume over the next two years results in a forecasted personnel increase of 30 percent for the same period. This method can be applied to specific positions and to the workforce in general. It is not, however, a very precise forecasting method. At the other end

human resources planning the development of strategies to meet a firm's future human resources needs of the spectrum are complex computer programs that perform HRM activities, such as forecasting future human resources requirements using algorithms and demographic data.

9-2b Forecasting Human Resources Supply

A forecast of human resources supply must take into account both the present workforce and any changes that may occur within it. For example, suppose that planners project that in five years a firm that currently employs 100 engineers will need to employ 200 engineers. Forecasting is not as simple as planning to hire 100 additional engineers. Some of the firm's current engineers will leave, move to other jobs within the firm, or be promoted. Thus, planners may project the supply of current engineers in five years at 87, which means that the firm will have to hire a total of 113 new engineers. When forecasting supply, planners should also account for the organization's existing employees to determine who can be retrained to perform required tasks.

ISTOCK.COM/CREDIT:HISPANOLISTIC

The demand for labor versus its supply: a balancing act. The supply and demand for employees with different skills is constantly shifting. In some industries, qualified workers are plentiful. In others, they are hard to find, even when the nation's unemployment rate is high.

Two useful techniques for forecasting human resources supply are the replacement chart and the skills inventory. A **replacement chart** is a list of key personnel and their possible replacements within a firm. It is important to maintain this chart to ensure that top-management positions can be filled quickly in the event of an unexpected death, resignation, or retirement. Some firms provide additional training for employees who might eventually replace top managers.

A **skills inventory** is a searchable database containing information on the skills and experience of all present employees, which can be mined to find candidates to fill available positions. For a special project, a manager may be seeking a current employee with specific information technology skills, at least six years of experience, and fluency in French. The skills inventory can quickly identify qualified employees. Skill-assessment tests, which provide the information in a skills inventory, can be administered internally or by outside vendors. Some companies, such as Halogen Software, offer customizable skills assessment and training software that allows firms to examine skills more expertly without contracting with an outside provider.

replacement chart a list of key personnel and their possible replacements within a firm

skills inventory a computerized data bank containing information on the skills and experience of all present employees

9-2c Matching Supply with Demand

Once they have forecasted the supply and demand for personnel, HR planners can then devise a course of action for matching one with the other. When demand is predicted to be greater than supply, they must make plans to recruit new employees. The timing of recruitment efforts depends on the types of positions to be filled. Suppose that we expect to open another plant in five years that will need a plant manager and 25 maintenance workers, along with additional support staff. We can wait to recruit maintenance personnel. However, because the job of a plant manager is so critical, we may begin the process to fill that position immediately. If the demand excess is expected to be temporary, a firm might contract with a service that supplies temp workers. On the other hand, when the supply of employees is predicted to be greater than demand, the firm must take steps to reduce the size of its workforce, sometimes known as *rightsizing*. We will take a look at how firms can increase or reduce the size of their workforces later in this chapter.

✓ Concept Check

- How do firms forecast the demand for human resources?
- What are the techniques used to forecast human resources supply?
- How can firms match human resources supply and demand?

9-3 Workplace Diversity

Learning Objective

9-3 Discuss workplace diversity and some of the challenges and opportunities associated with it.

Today's workforce is highly diverse, with employees bringing a wide variety of beliefs, expectations, perspectives, and behavioral norms. Managers must be sensitive to and aware of these differences. For instance, European businesspeople may offer a kiss on the cheek as a greeting. Latin Americans tend to stand closer to people with whom they are talking than North Americans prefer. Without cultural sensitivity, job applicants who will not make eye contact during an interview may be rejected for being unapproachable, when, according to their culture, they are just being polite.

A large number of women, immigrants, and people of color have entered the U.S. workforce in recent decades. It is estimated that women make up about 47 percent of the U.S. workforce; African Americans and Hispanics each make up about 13 and 18 percent of U.S. workers, respectively.[2] Women now account for the majority of workers in the financial, education and health services, and leisure and hospitality industries. They make up 52 percent of management professional and related positions in the United States.[3]

Workplace diversity refers to the differences among people in a workforce owing to factors such as age, race, ethnicity, gender, sexual orientation, and ability. An increasingly diverse workforce requires that managers learn to supervise and motivate people who have a broad range of value systems as well as personal needs. In addition to cultural diversity, other changes have taken place as well. The high proportion of women in the workforce, combined with a new emphasis on participative parenting by men, has brought many family-related issues to the workplace. Today's more educated employees also want greater independence and flexibility, leading to improved quality of life.

Although workplace diversity presents a challenge, astute managers embrace it as an opportunity rather than a limitation. When fostered, diversity and inclusion can result in a stronger organization. Table 9-1 shows several benefits that diversity can bring to an inclusive organization, such as cost and human resources advantages. In particular, a diverse organization may gain a marketing and hiring edge because it has a greater understanding of different cultures and languages. Proper guidance and management of diversity in an organization also can improve creativity. People who embrace workplace diversity frequently are more flexible in the types of positions they will accept and are more comfortable working with diverse co-workers. Indeed, research by McKinsey & Company found that the top 25 percent of ethically and culturally diverse companies outpace the 25 percent least diverse ones by 36 percent in terms of profitability.[4]

workplace diversity differences among people in a workforce owing to factors such as age, race, ethnicity, gender, sexual orientation, and ability

Because workplace diversity creates challenges along with advantages, it is important for an organization's employees to understand it. To accomplish this goal, numerous U.S. firms have trained their managers to respect and support diversity

Table 9-1 Benefits of Workplace Diversity

Benefit	Description
Better use of employee talent	Companies gain a competitive advantage when they recruit, retain, and advance the best talent.
Improved understanding of the marketplace	A more diverse workforce can more easily anticipate and respond to the changing needs and desires of diverse customers.
Greater scope of understanding in leadership positions	A diverse leadership team can bring more perspectives to bear on anticipating and responding to a complex and dynamic environment.
Increased quality of team problem solving	Diverse teams can often devise more creative ideas and better solutions to problems.
Reduced costs associated with high turnover, absenteeism, and lawsuits	Flexible workplaces that satisfy and motivate employees with a variety of needs and wants help companies retain and advance the best talent.

Source: Adapted from Richard L. Daft and Dororthy Marcic, *Understanding Management,* 11th ed. (Boston, MA: Cengage, 2020), 339.

and inclusion. Diversity training programs may include recruiting, training, and mentoring women and people from underrepresented groups; training managers to view diversity positively, teaching English as a second language; and facilitating support groups for immigrants. Many companies recognize the importance of in-depth diversity training programs. A growing number of companies are publicly reporting their efforts to become more diverse and inclusive. Target, for example, releases an annual report that describes its current employee breakdown and diversity and inclusion efforts along with goals for the future.[5] More companies are also hiring diversity executives to help them reach their objectives. At Verizon, for example, Magda Yrizarry is the senior vice president and Chief Diversity Officer, which involves efforts to develop more opportunities for women, people of color, people with disabilities and neurodiversity, the LGBTQ+ community, and veterans.[6] International companies are continuously expanding their business and therefore need to meld a cohesive workforce from a labor pool with ever more diverse demographics.

ISTOCK.COM/DELMAINE DONSON

Why hiring a diverse group of employees can benefit your business. Organizations that hire diverse employees benefit from their different skills and life experiences. The different points of view of these workers can help a firm find new opportunities and ways of doing things. In addition, diverse employees often have a greater understanding of diverse customers and the goods and services they prefer.

A diversity program will be successful only if it is systematic, is ongoing, and has a strong, sustained commitment from top leadership. Diversity training can improve workplace attitudes and behaviors. Even though there may be resistance in certain situations, workplace diversity is here to stay. Its impact on organizations is widespread and will continue to grow. Management must learn to overcome the obstacles and capitalize on the advantages associated with culturally diverse human resources.

✓ Concept Check

- What is workplace diversity?
- What are some of the benefits and challenges of workplace diversity?

Ethics and Social Responsibility

Apple Doubles Down on Racial Equity

Demand for diversity, equity, and inclusion initiatives in corporate America is on the rise. While many organizations have prioritized diversity efforts, equity remains a major issue in the workplace. Equity, which relates to equal opportunities and fair treatment, is at the center of Apple's $100 million Racial Equity and Justice Initiative (REJI).

Through REJI, Apple aims to lower systemic barriers to opportunity for communities of color by focusing on the next generation of leaders in technology. The funding will support the Propel Center in Atlanta (a global innovation and learning hub for historically Black colleges and universities), the Apple Developer Academy in Detroit (an education center for entrepreneurs, creators, and coders), and venture capital funding for 1,000 companies with diverse founders over the next 20 years. The Propel Center is a joint effort from Apple, Southern Company (an American energy company), and several community stakeholders that will support students both virtually and on-campus in Atlanta, Georgia. The Detroit-based developer academy is a collaboration with Michigan State University and will offer a 30-day introductory program as well as an extended boot camp.

In addition to REJI, Apple continues to build upon its contributions to community organizations such as community colleges, nonprofits, and other local organizations that empower the next generation. Apple's vice president of Environment, Policy, and Social Initiatives, Lisa Jackson, says "We are proud to lend our voices and resources to build new engines of opportunity that empower, inspire, and create meaningful change." In addition to REJI and community involvement, Apple has also made internal efforts to improve diversity, equity, and inclusion.

Sources: Based on information in Pavithra Mohan, "Apple Announces New Commitments to Its Racial Equity Initiative," *Fast Company*, January 12, 2021, www.fastcompany.com/90593786/apple-announces-new-commitments-to-its-racial-equity-initiative; Apple, "Apple Launches Major New Racial Equity and Justice Initiative Projects to Challenge Systemic Racism, Advance Racial Equity Nationwide," January 13, 2021, www.apple.com/newsroom/2021/01/apple-launches-major-new-racial-equity-and-justice-initiative-projects-to-challenge-systemic-racism-advance-racial-equity-nationwide/.

9-4 Job Analysis

Learning Objective

9-4 Explain the objectives and uses of job analyses.

job analysis a systematic procedure for studying jobs to determine their various elements and requirements

job description a list of the elements that make up a particular job

job specification a list of the qualifications required to perform a particular job

Managers need to understand the nature of a job before they can find the right person to do it. It would make no sense to hire new people without knowing why. **Job analysis** is a systematic procedure for studying positions to determine their various elements and requirements. Consider a clerk—in a large corporation, there may be 50 kinds of clerk positions, which may all differ in terms of activities performed, the level of proficiency required for each activity, and the set of qualifications demanded. These distinctions are the focus of job analysis.

The job analysis for a particular position typically consists of two parts—a job description and a job specification. A **job description** is a list of the elements that make up a particular job. It includes the duties to be performed, the working conditions, the responsibilities, and the tools and equipment that must be used on the job (refer to Figure 9-1). A **job specification** is a list of the qualifications required to perform a particular job, such as certain skills, abilities, education, and experience. In addition to requiring certain experience, some companies also list personality characteristics in job specifications.

The job analysis is not only the basis for recruiting and selecting new employees, but it is also used in other areas of HRM, including evaluation and the determination of equitable compensation levels.

✓ Concept Check

- What is job analysis?
- What is job specification?
- How can job specification be used to hire the right person for the job?

Figure 9-1 Job Description and Job Specification

This job description explains the job of sales coordinator and lists the responsibilities of the position. The job specification is contained in the last paragraph.

CENGAGE
JOB DESCRIPTION

TITLE: Georgia Sales Coordinator
DEPARTMENT: College, Sales
REPORTS TO: Regional Manager

DATE: 3/26/22
GRADE: 12
EXEMPT/NONEXEMPT: Exempt

BRIEF SUMMARY:
Supervise one other Georgia-based sales representative to gain supervisory experience. Captain the four members of the outside sales rep team that are assigned to territories consisting of colleges and universities in Georgia. Oversee, coordinate, advise, and make decisions regarding Georgia sales activities. Based upon broad contact with customers across the state and communication with administrators of schools, the person will make recommendations regarding issues specific to the needs of higher education in the state of Georgia such as distance learning, conversion to the semester system, potential statewide adoptions, and faculty training.

PRINCIPAL ACCOUNTABILITIES:

1. Supervises/manages/trains one other Atlanta-based sales rep.
2. Advises two other sales reps regarding the Georgia schools in their territories.
3. Increases overall sales in Georgia as well as his or her individual sales territory.
4. Assists regional manager in planning and coordinating regional meetings and Atlanta conferences.
5. Initiates a dialogue with campus administrators, particularly in the areas of the semester conversion, distance learning, and faculty development.

DIMENSIONS:
This position will have one direct report in addition to the leadership role played within the region. Revenue most directly impacted will be within the individually assigned territory, the supervised territory, and the overall sales for the state of Georgia.

KNOWLEDGE AND SKILLS:
Must have displayed a history of consistently outstanding sales in personal territory. Must demonstrate clear teamwork and leadership skills and be willing to extend beyond the individual territory goals. Should have a clear understanding of the company's systems and product offerings in order to train and lead other sales representatives. Must have the communication skills and presence to communicate articulately with higher education administrators and to serve as a bridge between the company and higher education in the state.

Exploring Careers

Sharpen These In-Demand Skills

Job hunting in a competitive job market has its challenges. To stand out as a candidate, it's important to focus on sharpening hard and soft skills that today's employers need. *Hard skills* refer to teachable abilities such as a business degree or proficiency in a foreign language while *soft skills* refer to interpersonal abilities such as teamwork and leadership. LinkedIn, the top social network for business professionals, used data from more than 20 million job listings and 660 million professional profiles to identify the most in-demand skills.

Today's most desirable hard skills relate to blockchain, cloud and distributed computing, analytical reasoning, artificial intelligence, user experience (UX) design, business analysis, affiliate marketing, sales, scientific computing, and video production. Most of these have a common thread: proficiency in emerging technologies. Without a doubt, analytical thinking and the ability to analyze data will be invaluable across industries as the business landscape evolves. The most in-demand soft skills include creativity, persuasion, collaboration, adaptability, and emotional intelligence.

Hard skills are easy to quantify and can be listed on a résumé or cover letter while soft skills can be more difficult to quantify. Instead, the ability to communicate these interpersonal abilities and characteristics during an interview is crucial. Candidates can share how they handled work challenges to show off soft skills. This is particularly important because soft skills are often key differentiators for job candidates as they are not as easily taught.

Sources: Based on information in Mara Leighton, "15 Skills LinkedIn Says Will Help You Get Hired in 2020 - and Where to Learn Them," *World Economic Forum*, September 3, 2020, www.weforum.org/agenda/2020/09/linkedin-online-elearning-skills-jobs-hiring/; Alison Doyle, "Hard Skills vs. Soft Skills: What's the Difference?" *The Balance Careers*, January 20, 2020, www.thebalancecareers.com/hard-skills-vs-soft-skills-2063780.

9-5 Recruiting, Selection, and Onboarding

Learning Objective

9-5 Describe the processes of recruiting, selecting employees, and onboarding.

In an organization with jobs waiting to be filled, HRM personnel need to (1) find candidates and (2) match the right candidate with each position. Three activities are involved: recruiting, selection, and new employee onboarding.

9-5a Recruiting

Recruiting is the process of attracting qualified job applicants. Because it is a vital link in a costly process (the cost of hiring an employee can be several thousand dollars), recruiting needs to be systematic. One goal of recruiters is to attract the "right number" of applicants, which is enough to allow a good match between applicants and open positions but not so many that matching requires a lot of time and effort. For example, if there are five open positions and five applicants, the firm has no choice. It must hire all five applicants (qualified or not). At the other extreme, if several hundred job seekers apply for the five positions, HRM personnel will spend weeks processing applications.

Recruiters may seek applicants outside the firm, within the firm, or both. The source used depends on the nature of the position, the situation within the firm, and sometimes the firm's established or traditional recruitment policies.

Organizations often start the recruiting process by considering current employees as applicants for available positions. Promoting from within provides strong motivation for current employees and helps the firm to retain quality personnel along with their experience. *Job posting*, or informing current employees of upcoming openings, is practiced by many different types of firms. It may be a

recruiting the process of attracting qualified job applicants company policy or be required by union contract. The primary disadvantage of internal recruiting is that promoting a current employee leaves another position open. Not only does the firm still incur recruiting and selection costs, but it also must train two employees instead of one.

In many situations it may be impossible to recruit internally. For example, no current employee may be qualified to fill a new position, or the firm may be growing so rapidly that there is no time to reassign positions that open as a result of promotion or transfer. In that case, companies turn to external recruiting.

External recruiting involves attracting job applicants from outside an organization. External recruiting may include activities on college campuses and open houses, job and career fairs, soliciting recommendations from current employees, posting in newspapers, employment agencies, and online efforts. Your college or university probably has an on-campus career center where many companies engage in recruiting activities. Some firms are becoming more creative to attract younger applicants. Taco Bell has held “hiring parties” to attract applicants, offering free food and branded merchandise and holding on-the-spot job interviews.[7] Of course, the internet is a popular medium for both recruiters and job seekers. Most large organizations devote portions of their websites to job postings. Online job sites such as Monster.com, Indeed.com, and SimplyHired.com help potential employees search for positions by criteria such as location, industry, or pay.

Increasingly, social media plays a significant role in the recruiting process. Savvy companies know that their social media pages like LinkedIn, Twitter, and Instagram are among their best recruiting tools, especially for reaching digital natives like Millennials and Generation Z. A survey by the Society for Human Resources Management found that 84 percent of employers look at social media sites—most

Technology and Innovation

Career Fairs Go Online

In-person career fairs have long been a mainstay of talent acquisition. Social distancing during the COVID-19 pandemic, however, increased demand for virtual career fairs and hiring events where recruiters and candidates interact through one-on-one chats and video calls. Though the concept is not new, the adoption of this strategic recruiting tool has risen sharply.

Now, in the wake of the global health crisis, it’s clear that the trend toward virtual career fairs is here to stay. Both job seekers and recruiters agree that online, cloud-based hiring events are flexible and efficient. Many human resources professionals have found that virtual career fairs are easy to promote, manage, and personalize, not to mention less costly than traditional career events. In addition, organizations can easily and efficiently collect attendee data.

The growing video communications market has spelled success for many technology companies such as Brazen, a virtual hiring event and online career fair software. Brazen experienced a surge in demand from retailers, healthcare organizations, tech companies, and educational institutions. Brazen’s technology has also been used by organizations to connect their laid-off and furloughed employees with other companies. The global pandemic accelerated the transition to remote work, a change that many organizations have made permanent. As more companies adopt a digital mentality, recruiting, selection, and orientation will increasingly occur online as well.

Sources: Based on information in Nicole Dienst and Kelsey Johnson, “How to Prepare for—and Land a Job—at a Virtual Career Fair,” *CNBC*, August 1, 2020, www.cnbc.com/2020/08/01/virtual-career-fairs-how-to-land-a-job-offer-at-an-online-event.html; Roy Maurer, “Career Fairs Go Virtual in Reaction to Pandemic,” *Society for Human Resource Management*, May 18, 2020, www.shrm.org/resourcesandtools/hr-topics/talent-acquisition/pages/career-fairs-go-virtual-reaction-covid19.aspx.

notably LinkedIn, Facebook, and Twitter— for recruiting purposes. The survey also found that 71 percent of companies employ social networking tools to identify and recruit applicants with specific skills, and 77 percent use social networking to raise their brand recognition.[8] Recruiters have learned that posting photos, videos, and stories about their firms humanizes them, demonstrates their culture, and depicts what it is like to work at them. Beyond posting current openings to attract today's job seekers, social recruiting can also build a following—and pool of future applicants—among those not yet in the workforce. Clearly, it is best to match the recruiting means with the kind of applicant being sought.

Job search...
START
ISTOCK.COM/LUMINEIMAGES

External recruiting has advantages and disadvantages. A primary advantage is that it brings people into a firm who have new perspectives and varied business backgrounds. Some firms prefer to hire recruits directly out of college because they believe that these candidates will be easier to train to fit with the corporate culture and the needs of the company. An additional benefit of hiring younger talent is that they tend to be more technologically savvy than their older counterparts, a characteristic that is highly desirable in today's workplace. A disadvantage of external recruiting is that it is often expensive, especially if private employment agencies must be used. External recruiting also may provoke resentment among present employees who wish to advance within the company.

9-5b **Selection**

Selection is the process of gathering information about applicants for a position and using that information to choose the most appropriate applicant. Note the use of the word *appropriate*. In selection, the idea is not to hire the person with the *most* qualifications but rather the applicant who is *most appropriate* for the job at hand—and also satisfies the firm's goals and fits into its overall culture. Line managers responsible for the position usually select applicants. However, HRM personnel usually help by developing a pool of applicants and by expediting their assessment. Common means of obtaining information about applicants' qualifications are employment applications, interviews, references, assessment centers, and social networking sites like LinkedIn and Facebook. Indeed, in many cases, social networking has changed the order in which employers receive information. Employers can peruse LinkedIn accounts, for example, to see reviews and recommendations before even interviewing a candidate. Some companies today are also showing candidates realistic job previews (RJPs)—authentic presentations that depict both positive and negative aspects of the job along with the company's culture. Presenting such realistic information about the job may weed out less interested candidates before they reach more costly steps in the selection process.

Employment Applications An employment application is useful for collecting factual information on a candidate's education, work experience, and personal history (refer to Figure 9-2). The data from applications are used for two purposes: to identify applicants who are worthy of further scrutiny and to familiarize interviewers with applicant backgrounds. Online applications are common, which helps to streamline the process and improve data-gathering capabilities for the firm. In fact, paper applications are becoming rare.

Many job candidates submit résumés, and some firms require them. A *résumé* is a one- or two-page summary of the candidate's background and qualifications. It may include a description of the type of job the applicant is seeking. A résumé may be sent to a firm to request consideration for available jobs, or it may be submitted along with an employment application.

selection the process of gathering information about applicants for a position and then using that information to choose the most appropriate applicant

Figure 9-2 **Typical Employment Application**

Employers use applications to collect factual information on a candidate's education, work experience, and personal history.

EMPLOYMENT APPLICATION

LIGHTFIELD STUDIOS INC./ALAMY STOCK PHOTO

To improve the usefulness of information, HRM specialists ask current employees about experiences and characteristics that relate to their current jobs. These factors are included on the applications and may be weighted more heavily when evaluating new applicants' qualifications.

Employment Tests Tests administered to job candidates usually focus on aptitudes, skills, abilities, or knowledge relevant to the job. Such tests (basic computer skills tests, for example) help an employer gauge how well the applicant can perform the job. Companies may use general intelligence or personality tests, but these are seldom helpful in predicting performance. Many organizations of all sizes use predictive behavior tests, which have become more affordable with improved technology.

Interviews The interview is perhaps the most widely used selection technique because it provides an opportunity for applicants and the firm to learn more about one another. Job candidates are interviewed by at least one member of the HRM staff and by the person for whom they will be working. Candidates for higher-level jobs may meet with a department head or vice president over several interviews.

Interviewers may pose problems to test the candidate's abilities, probe employment history, and learn something about the candidate's attitudes and motivation. The candidate has a chance to find out more about the job and potential co-workers. Interviews also provide an opportunity to test the personality fit of a candidate with the organizational culture. Many organizations now conduct interviews remotely using services such as Skype, Zoom, or gotomeeting.com, only flying in the most promising candidates for face-to-face meetings.

Unfortunately, interviewing may be the stage at which discrimination begins. For example, suppose that an applicant mentions that they are the parent of small children. The interviewer may assume that the applicant will be resistant to job-related travel, even though that may not be true. In addition, interviewers may be unduly influenced by such factors as appearance. They may also ask different questions of different applicants so that it becomes impossible to compare candidates' qualifications objectively. Some of these problems can be solved through better interviewer training and by using structured interviews. In a *structured interview*, the interviewer asks only a prepared set of job-related questions. The firm also may consider using several different interviewers for each applicant, but this can be costly.

References A job candidate generally is asked to furnish the names of references—people who can verify background information and provide personal evaluations. Naturally, applicants tend to list only references who are likely to say good things. Thus, personal evaluations obtained from references may not be of much value. However, references are often contacted to verify such information as previous job responsibilities and the reason an applicant left a former job.

ISTOCK.COM/KATE_SEPT2004

A job interview is similar to a first date. Like a date, interviews can occur in a variety of locations and through several formats. The purpose is to give the candidate and the company the opportunity to find out about each other. Can you think of any other selection methods that benefit *both* parties in the recruiting process?

Assessment Centers An assessment center is used primarily to select current employees for promotion to higher-level positions. Typically, a group of employees is sent to the center for a few days. While there, they participate in activities designed to simulate the management environment and to predict managerial effectiveness. Trained observers make recommendations regarding promotion possibilities. The expense of this technique limits its use.

9-5c Onboarding

Once all information about job candidates has been collected and analyzed, the company extends a job offer. If it is accepted, the candidate becomes an employee. Soon after a candidate joins a firm, they go through the firm's onboarding program. **Onboarding** is the process of integrating new employees into the organization. It is a process that can take weeks or months and involves welcoming the new employee, helping them build relationships with managers and team members, providing training and tools to carry out their assignments, and most importantly, acclimating them to the firm's culture. One step in onboarding is **orientation**, the basic introduction of new employees to the organization. Orientation typically involves the initial hiring paperwork, supplying the employee handbook, explaining benefits, touring the facilities, and furnishing keys, logins, passwords, and the like. Larger companies may begin the onboarding process several days before new employees' first day by sending them a welcome package that includes access to an online onboarding dashboard, to help employees feel ready to get to work. Some may also assign a mentor or buddy that a new hire can shadow to learn the ropes. Strong onboarding programs also have new employees regularly check in about how they are doing so that managers can offer feedback and provide support.

Companies are increasingly recognizing that a strong onboarding process can boost new employee retention. One survey found that 31 percent of new hires leave within the first six months.[9] Ensuring that new hires feel welcomed and valued, and know what to do to carry out their assignments and where to go for support, makes it less likely they will leave the firm due to dissatisfaction. Keeping all employees happy is a major goal of human resources management.

onboarding the process of integrating new employees into an organization

orientation the basic introduction of new employees to an organization

✓ Concept Check

- What are the differences between internal and external recruiting?
- Under what conditions are each one of them used?
- Identify and briefly describe the types of practices and tools that are used in the selection process.
- How does onboarding help improve employee retention?

9-6 Compensation and Benefits

Learning Objective

9-6 Examine decisions associated with employee compensation and benefits.

An effective employee reward system must (1) enable employees to satisfy basic needs, (2) provide rewards comparable with those offered by other firms, (3) be distributed fairly within the organization, and (4) recognize that different people have different needs. A firm's compensation system can be structured to meet the first three of these requirements. The fourth is more difficult because it must account for many variables. Most firms offer a number of benefits that, taken together, generally help to provide for employees' varying needs.

9-6a Compensation Decisions

Compensation is the payment employees receive in return for their labor. Its importance to employees is obvious. Because compensation can account for a significant percentage of a firm's operating costs, it is also an important consideration for management. Therefore, the firm's **compensation system**, the policies and strategies that determine employee compensation, must be designed carefully to provide for employees' needs while keeping labor costs within reasonable limits. For most firms, designing an effective compensation system requires three separate management decisions—wage level, wage structure, and individual wages.

Wage Level Management first must position the firm's general pay level relative to pay levels of comparable firms. Most firms choose a level near the industry average. However, a firm that is not in good financial shape may pay less than average, and large, prosperous organizations may pay more than average. Consider PayPal, which chose to give pay raises to its call center employees even though they were already being paid above market rate. CEO Dan Schulman said the pay raises helped ensure that each employee had a net disposable income of at least 20 percent. Schulman says, "You can't have passionate employees if every month they are worried about how they are going to make ends meet."[10] To determine the average pay for a job, the firm may use wage surveys. A **wage survey** is a collection of data on prevailing wage rates within an industry or a geographic area. Such surveys are compiled by industry associations, local governments, personnel associations, and (occasionally) individual firms.

Wage Structure Next, management must decide on relative pay levels for all the positions within the firm. The result of this set of decisions is called the firm's *wage structure*. The wage structure almost always is developed on the basis of a job evaluation. **Job evaluation** is the process of determining the relative worth of the various jobs within a firm. Most observers probably would agree that an administrative assistant should make more money than a custodian, but how much more?

A number of techniques may be used to evaluate jobs. The simplest is to rank all the jobs within the firm according to value. A more frequently used method is based on the job analysis. Points are allocated to each element and job requirement. For example, "college degree required" might be worth 50 points, whereas a job requiring only a high school diploma would only receive 25 points. The more points allocated, the more important the job is presumed to be (and the higher its level in the firm's wage structure).

compensation the payment employees receive in return for their labor

compensation system the policies and strategies that determine employee compensation

wage survey a collection of data on prevailing wage rates within an industry or a geographic area

job evaluation the process of determining the relative worth of the various jobs within a firm

Individual Wages Finally, the company must determine the specific payments individual employees will receive. Consider the case of two administrative assistants. Job evaluation was used to determine the level of administrative pay, but suppose that one assistant has 15 years of experience, can type 80 words per minute accurately, and can work in several computer programs, while the other has two years of experience, can type only 55 words per minute, and knows only one computer program. In most firms, a wage range would be established (maybe $10.00 to $15.00 per hour) to reflect the range of experience and abilities, with the more qualified administrative assistant receiving the higher wage.

Two wage decisions come into play here. First, the employee's initial rate must be established. It is based on experience, other qualifications, and expected performance. Later, the employee may be given pay increases based on seniority and performance.

ISTOCK.COM/ANNA PECHERSKAIA

9-6b **Types of Compensation**

Compensation can take a variety of forms. Most forms fall into the following categories: hourly wage, weekly or monthly salary, commissions, incentive payments, lump-sum salary increases, and profit sharing.

Hourly Wage An **hourly wage** is a specific amount of money paid for each hour worked. People who earn wages are paid their hourly wage for the first 40 hours worked in any week. Anything in excess of 40 hours is overtime, for which they are paid one-and-one-half times their hourly wage. Workers in retail and fast-food chains, on assembly lines, and in clerical positions usually are paid an hourly wage.

Weekly or Monthly Salary A **salary** is a specific amount of money paid for an employee's work during a set calendar period, regardless of the actual number of hours worked. Salaried employees receive no overtime pay, but they do not lose pay when they work less than 40 hours per week. Most professional and managerial positions are salaried.

Commissions A **commission** is a payment that is a percentage of sales revenue. Sales representatives and sales managers often are paid entirely through commissions or a combination of commissions and salary.

Incentive Payments An **incentive payment** is in addition to wages, salary, or commissions. Incentive payments are rewards for outstanding job performance. They may be distributed to all or only select employees. Some firms distribute incentive payments to all employees annually. The size of the payment depends on the firm's earnings and, at times, on the particular employee's length of service with the firm. One of the most common incentive payments is the *bonus,* a payment given beyond base pay, often at the end of the year. These payments can serve as a thank you for hard work or persevering in tough times. McDonald's, for example, gave employees at company-owned stores a bonus of 10 percent of one month's earned pay to show its appreciation of their efforts during the COVID-19 pandemic. Many of its franchisors also awarded bonuses or gift cards to their employees.[11] Firms sometimes offer incentives to team members that exceed specific sales or production goals, a practice called *gainsharing*. Some organizations reward outstanding workers individually through *merit pay*. Such incentive payments allow management to control labor costs while encouraging employees to work more efficiently.

Lump-Sum Salary Increases In traditional reward systems, an annual pay increase is spread evenly across each paycheck that year. However, some companies offer a **lump-sum salary increase**. This gives employees the option of taking the entire pay raise in one lump sum. Employees then draw their "regular" pay for the rest of the year. The lump-sum payment typically is treated as an interest-free loan that must be repaid if an employee leaves the firm during the year.

hourly wage a specific amount of money paid for each hour of work

salary a specific amount of money paid for an employee's work during a set calendar period, regardless of the actual number of hours worked

commission a payment that is a percentage of sales revenue

incentive payment a payment in addition to wages, salary, or commissions

lump-sum salary increase an entire pay raise taken in one lump sum

Profit Sharing **Profit sharing** is the distribution of a percentage of a firm's profit among its employees. The idea is to motivate employees to work effectively by giving them a stake in the company's financial success. For example, every year since 1938 Hormel Foods Corporation has distributed its profits to employees in the form of dividends at the beginning of the winter holiday season. The higher the profits, the higher the dividends employees earn.[12]

9-6c Closing the Gender Gap

It is an established fact that women in the workforce are paid less than men, in spite of measures and legislation to counter this phenomenon. Analysis of median hourly compensation of both full- and part-time U.S. workers by the Pew Research Center found that women today still earn just 85 percent of what men do, although this gap has narrowed from 67 percent in 1980.[13] This gap is larger for women of color: Black women earn about 62 percent and Hispanic women about 54 percent, on average.[14] Moreover, women continue to report pay inequality and gender discrimination in the workplace. Addressing pay inequality is complicated. Studies have shown that, even after controlling for educational attainment and profession, wage gaps persist between men and women. Research suggests that factors behind the continuing wage disparity may include the idea that women are less inclined to ask for raises and that working mothers are less likely to work long hours or at specific times.

In recent decades, many states have taken steps to ensure that all workers have equal pay for comparable worth, but the issue is contentious. Critics argue that inflating salaries artificially for female-dominated occupations encourages women to keep these jobs rather than seek out higher-paying jobs. Increasingly, companies are taking steps to address the gender wage gap by conducting pay-equity analyses and publicizing the results of their investigations into their own pay gaps. Salesforce, for example, acknowledged that a review of all 17,000 employees' salaries identified gaps; the company spent nearly $9 million extra on payroll over several years to close the gap.[15] Citigroup, Starbucks, MasterCard, Facebook, Apple, Google, Intel, and Microsoft have disclosed the results of reviews of employee pay to highlight their efforts in narrowing their pay gap.[16] In any case, closing the gender gap can help companies attract and retain the best employees. Salesforce CEO Marc Benioff, for example, believes his company's efforts to close the gap helped propel it to the top of *Fortune*'s list of "Best Companies to Work For" and *People*'s list of "Companies That Care."[17]

9-6d Employee Benefits

An **employee benefit** is a reward in addition to regular compensation that is provided indirectly to employees. Employee benefits consist mainly of services (such as health and life insurance) that are paid for partially or totally by employers, and employee expenses (such as college tuition) that employers reimburse. Currently, the average cost of these benefits in private industry is 30 percent of an employee's total compensation.[18] Thus, a person who receives a salary of $35,000 really receives total compensation of $50,000, once $15,000 in benefits (30 percent of $50,000) is factored in.

profit sharing the distribution of a percentage of a firm's profit among its employees

employee benefit a reward in addition to regular compensation that is provided indirectly to employees

Types of Benefits Employee benefits take a variety of forms. *Pay for time not worked* covers such absences as vacation, holidays, and sick leave. *Insurance packages* may include health, life, vision, and dental insurance for employees and their families. Some firms pay the entire cost of the insurance package, and others share the cost with the employee. The costs of *pension and retirement programs* also may be borne entirely by the firm or shared with the employee.

EMPLOYEE
BENEFITS

ISTOCK.COM/JUSTSTOCK

What job benefits are crucial to you? The benefits companies provide vary widely. Large companies are often able to offer employees more benefits than small ones. However, in small firms, employees are more likely to do a broader range of tasks and advance to higher positions more quickly.

Some benefits are required by law. For example, employers must maintain *workers' compensation insurance*, which pays medical bills for injuries that occur on the job and provides income for employees who are disabled by job-related injuries. Employers must also pay for *unemployment insurance* and contribute to each employee's federal *Social Security* account.

Other benefits employers may provide include tuition-reimbursement plans, credit union memberships, child-care services, company cafeterias, exercise rooms, and broad employee stock-option plans. Some companies offer special benefits to U.S. military reservists who are called up for active duty. Increasingly, companies offer more varied benefits to attract and retain the best employees. In the high-tech industry, competition for talented employees is so intense that many firms have adopted more extreme perks, such as free meals, extended parental leave (up to one year at Netflix), on-campus amenities like fitness and recreation, free paid days off, travel stipends, fertility assistance, and even student loan debt reimbursement.[19]

Flexible Benefit Plans Through a **flexible benefit plan**, employees receive a predetermined amount of benefit dollars and may allocate those dollars to various categories of benefits in the way that best fits their needs. Sometimes these are known as *cafeteria plans* because employees can pick and choose what best works for them. Some flexible benefit plans offer a broad array of benefit options, including healthcare, dental care, life insurance, accidental death and dismemberment coverage for the worker and dependents, long-term disability coverage, vacation benefits, retirement savings, and dependent-care benefits. Other firms offer limited options, primarily in health and life insurance and retirement plans.

flexible benefit plan
compensation plan whereby employees receive a predetermined amount of benefit dollars to spend on a package of benefits they have selected to meet individual needs

Although the cost of administering flexible plans is high, a number of organizations, including Phillips Corporation and Coca-Cola, have implemented this option. Because employees' needs are so diverse, flexible plans help firms to offer benefit packages that more specifically meet their employees' needs. Flexible plans can, in the long run, help a company contain costs because a specified amount is allocated to cover the benefits of each employee. Furthermore, organizations that offer flexible plans with many choices may be perceived as being employee-friendly. Thus, they are in a better position to attract and retain qualified employees.

✓ Concept Check

- Identify the major compensation decisions that HRM managers make.
- What are the different forms of compensation?
- What are the major types of employee benefits?
- How do flexible benefit plans work?

Entrepreneurial Success

Small Businesses Focus on Better Benefits

Working professionals have increasingly high expectations when it comes to employee benefits. From on-site child care to pet insurance, many individuals want better benefits than healthcare alone. Historically, offering competitive perks has been a challenge for small businesses and start-ups because they can be costly and time-intensive to manage. Now, a new wave of human resources (HR) providers and benefits managers such as TriNet, Zenefits, and Gusto are making better benefits a reality.

When entrepreneurs run a business, they often wear many hats such as CEO, sales manager, and HR manager. They often do not have the personal bandwidth or financial resources to offer the types of benefits that large corporations provide. However, having the right mix of benefits can be critical for retaining employees. TriNet is one cloud-based HR solution that small businesses have turned to. The company can handle everything from payroll to benefits administration and can offer the same scale that larger companies have.

According to a study by LaSalle Network, shopping for better benefits is one of the top three reasons Millennials leave their jobs. As it is, employees ages 18 to 34 are already more likely to job hop. The most desirable benefits include matching contributions to 401(k) savings programs, student loan assistance, generous paid time off, flexible working arrangements, and remote work opportunities. With competitive benefits, start-ups have a better chance of recruiting and retaining high-quality talent.

Sources: Based on information in Jessica Dickler, "Why Small Businesses Are Banking on Better Benefits," *CNBC*, January 25, 2020, https://www.cnbc.com/2020/01/24/why-small-businesses-are-banking-on-better-benefits.html; Nadine El-Bawab, "More Millennials Are Demanding These Workplace Perks," *CNBC*, February 7, 2019, www.cnbc.com/2019/02/07/millennials-are-demanding-these-workplace-perks.html.

9-7 Training and Development

Learning Objective

9-7 Explain the purposes and techniques of employee training and development.

Training and development are extremely important in helping employees succeed at their jobs and for companies to retain them. As such, they represent a major investment in human resources. For Dollar General, the importance of training is evidenced by its recent induction into *Training* magazine's "Hall of Fame" list. Dollar General has made *Training*'s "Top 125" list for nine consecutive years, distinguishing itself through its effectiveness and efficiency, number of training hours logged by employees, and survey results. Employees log nearly 1.7 million training hours annually, using a range of technologies, including mobile and online learning. The company offers nearly 12,000 courses to employees to ensure that they continue their professional development.[20] Many top managers believe that the financial and human resources invested in training and development are well worth it. Employees at all levels of a company need training and/or development about its products, specific computer programs and protocols, customer needs, company policies and codes of conduct, applicable regulations, competitors' products, and more.

Both training and development are aimed at improving employees' skills and abilities. However, the two are usually differentiated as employee training or management development. **Employee training** is the process of teaching operations and technical employees how to do their present jobs more effectively and efficiently. **Management development** is the process of preparing managers and other professionals to assume increased responsibility in both present and future positions. Thus, training and development differ in who is being taught and the purpose of the teaching. However, both are necessary for personal and organizational growth. Additionally, a number of companies encourage this growth through more informal mentorship programs. **Mentors** are older, higher-ranked employees who instruct, advise, and offer support to younger employees in the ways of the organization

employee training the process of teaching operations and technical employees how to do their present jobs more effectively and efficiently

management development the process of preparing managers and other professionals to assume increased responsibility in both present and future positions

mentors older, higher-ranked employees who instruct, advise, and offer support to younger employees in the ways of the organization and industry and industry. In some cases, companies use reverse mentoring by asking younger employees to advise senior staff members about technology and social media.

Companies that hope to stay competitive typically make huge commitments to employee training and development. Indeed, training accounts for about $82.5 billion of business spending in the United States.[21] Developing an effective training program involves analyzing needs, determining the best methods, and developing an evaluation system to gauge effectiveness. Some employers require workers to attain certifications targeted to their field to help them gain and maintain the specific skills they need. There are many different employee training methods, including internet-based training. Internet training is growing in popularity as it can result in significant cost, travel, and time savings.

9-7a Analysis of Training Needs

When thinking about developing a training program, managers first must determine if training is actually needed and, if so, what types of training needs exist. Training needs can vary considerably. For example, some employees may need to improve their technical skills, while others need training on organizational procedures. Training also may focus on business ethics, product information, or customer service. Because training is expensive, it is critical that the correct training needs be identified. Employers may find that sometimes employees need motivation more than they need training.

9-7b Training and Development Methods

A number of methods are available for employee training and management development. Most of these methods can be applied to both training and management development.

- *On-the-job methods*. The trainee learns by doing the work under the supervision of an experienced employee.
- *Simulations*. The work situation is simulated in a separate area so that learning takes place away from the day-to-day pressures of work.
- *Classroom teaching and lectures*. Instructors present concepts and illustrations through a variety of techniques.
- *Conferences and seminars*. Experts and learners come together to discuss problems and exchange ideas.
- *Role-playing*. Participants act out others' roles in order to better understand them (primarily a management development tool).
- *e-Learning*. Participants train by watching videos of lectures or how-to guides, playing "games" that simulate work situations, or taking online quizzes to demonstrate their proficiency in a topic.

9-7c Evaluation of Training and Development

Training and development are expensive because the training itself can be costly and employees are not working at full productivity while they are receiving training, costing the firm further revenue. To ensure that training and development are as cost-effective as possible, the managers responsible should evaluate the company's efforts periodically.

ISTOCK.COM/RAINSTAR

What job training methods have you experienced, and how effective were they? Organizations train employees using a variety of methods and locations. Depending on the type of business, the training may take just a few hours or more than a year.

✓ Concept Check

- What is the difference between employee training and management development?
- What are the primary training and development methods used by firms?

In order to set benchmarks and gauge program effectiveness, managers should develop measurable objectives before the training starts. For example, a measurable object would be that, after receiving training, a new employee will be able to produce a report using a specified format and be able to correctly identify 20 critical terms related to the field. The results of training evaluations should be made known to all those involved in the program—including trainees and upper management. For trainees, the results of evaluations can enhance motivation and learning. For upper management, the results may be the basis for making decisions about the training program itself.

9-8 Performance Appraisal

Learning Objective

9-8 Discuss performance appraisal techniques and performance feedback.

Performance appraisal is the evaluation of employees' performance to allow managers to make unbiased human resources decisions. For many firms, these appraisals occur once a year, but more organizations are beginning to drop the annual performance review in favor of more frequent feedback sessions that account for changing priorities and situations. The financial services firm Deloitte, for example, has employees check in with supervisors every other week about their performance progress, challenges, successes, and career aspirations.[22] Some companies call this approach *performance management* because it is ongoing and helps employees be their best.

Regardless of frequency, the appraisal process has three main objectives. First, managers use performance appraisals to let workers know how well they are doing and how they can improve. Second, a performance appraisal provides an effective basis for distributing rewards, such as pay raises and promotions. Third, performance appraisal analysis helps the organization monitor its employee selection, training, and development activities. If large numbers of employees continually perform below expectations, the firm may need to revise its selection process or strengthen its training and development activities. Most performance appraisal processes include a written document. An example appears in Figure 9-3.

9-8a Common Evaluation Techniques

The techniques and methods for appraising employee performance are either objective or judgmental in nature.

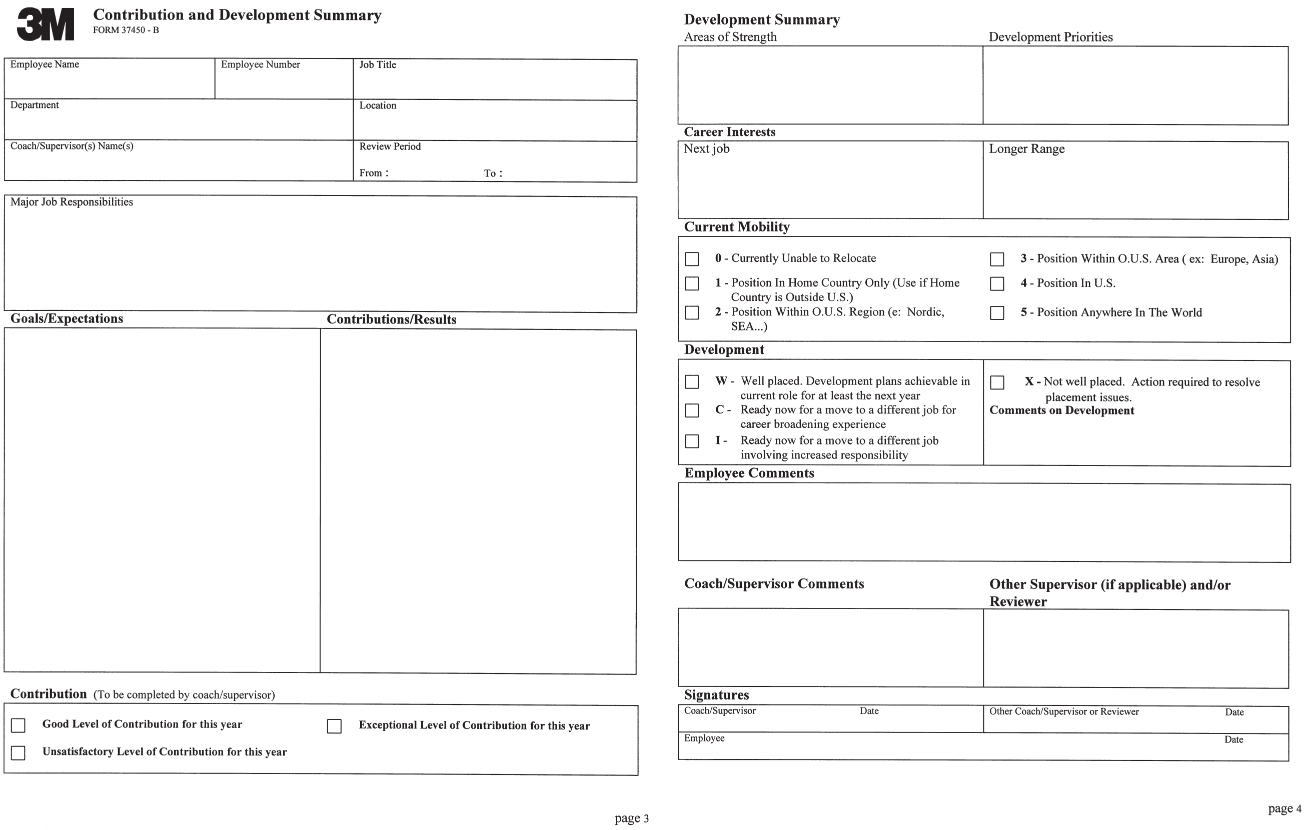
Objective Methods Objective appraisal methods use some measurable quantity as the basis for assessing performance. Units of output, dollar volume of sales, number of defective products, and number of insurance claims processed are all objective, measurable quantities. Thus, an employee who processes an average of 26 insurance claims per week is given a higher evaluation than one whose average is 19 claims per week.

Such objective measures may require adjustment depending on the work environment. Suppose that the first of our insurance claims processor works in New York City and the second works in rural Iowa. Both must visit each client because they are processing homeowners' insurance claims. The difference in their average weekly output may be entirely because of the long distances the Iowan must travel to visit clients. In this case, the two workers may very well be equally competent and motivated. Thus, a manager must take into account circumstances that may be hidden by a purely statistical measurement.

performance appraisal the evaluation of employees' performance to allow managers to make objective human resources decisions

Judgmental Methods Judgmental appraisal methods are used much more frequently than objective methods. They require that the supervisor judge or estimate the employee's performance level. These methods are based on

Figure 9-3 Performance Appraisal



3M **Contribution and Development Summary**
FORM 37450 - B

Employee Name	Employee Number	Job Title
Department		Location
Coach/Supervisor(s) Name(s)		Review Period From : To :

Major Job Responsibilities

Goals/Expectations	**Contributions/Results**

Contribution (To be completed by coach/supervisor)

☐ **Good Level of Contribution for this year** ☐ **Exceptional Level of Contribution for this year**
☐ **Unsatisfactory Level of Contribution for this year**

page 3

Development Summary

Areas of Strength	Development Priorities

Career Interests

Next job	Longer Range

Current Mobility

☐ **0** - Currently Unable to Relocate
☐ **1** - Position In Home Country Only (Use if Home Country is Outside U.S.)
☐ **2** - Position Within O.U.S. Region (e: Nordic, SEA...)
☐ **3** - Position Within O.U.S. Area (ex: Europe, Asia)
☐ **4** - Position In U.S.
☐ **5** - Position Anywhere In The World

Development

☐ **W** - Well placed. Development plans achievable in current role for at least the next year
☐ **C** - Ready now for a move to a different job for career broadening experience
☐ **I** - Ready now for a move to a different job involving increased responsibility
☐ **X** - Not well placed. Action required to resolve placement issues.
Comments on Development

Employee Comments

Coach/Supervisor Comments	**Other Supervisor (if applicable) and/or Reviewer**

Signatures

Coach/Supervisor Date	Other Coach/Supervisor or Reviewer Date
Employee	Date

page 4

Source: Courtesy of 3M.

employee ranking or rating scales. When ranking is used, the manager ranks subordinates from best to worst. This approach has drawbacks, including the lack of an absolute standard. Use of rating scales is the most popular judgmental appraisal technique. A *rating scale* consists of a number of statements, on which each employee is rated based on the degree to which the statement applies. For example, one statement might be, “This employee always does high-quality work.” The supervisor would give the employee a rating, from 5 down to 1, corresponding to gradations ranging from “strongly agree” to “strongly disagree.” The ratings on all the statements are added to obtain the employee’s total evaluation.

Avoiding Appraisal Errors Managers must be cautious if they are to avoid making mistakes when appraising employees. It is common to overuse one portion of an evaluation instrument, thus risking overemphasizing or underemphasizing issues. Supervisors must guard against allowing an employee’s poor performance on one activity to influence their judgment of that subordinate’s work on other activities. Similarly, putting too much weight on recent performance can distort an employee’s evaluation. For example, if the employee is being rated on performance over the last year, a manager should not permit last month’s disappointing performance to overshadow the quality of the work done in the first 11 months of the year. Finally, a manager must guard against discrimination on the basis of race, age, gender, religion, national origin, or sexual orientation.

9-8b **Performance Feedback**

No matter which appraisal technique is used, managers should discuss the results with the employee soon after completion. The manager should explain the basis for present rewards and let the employee know what can be done to improve. The supervisor can also communicate about opportunities for training and development to help employees overcome any performance deficiencies and develop new skills to advance in their careers. The information provided to an employee in such discussions is called *performance feedback*, and the process is known as a *performance feedback interview*.

There are three major approaches to performance feedback interviews: tell-and-sell, tell-and-listen, and problem solving. In a *tell-and-sell* feedback interview, the superior tells the employee how good or bad the employee's performance has been and attempts to persuade the employee to accept the evaluation. Because the employee has no input into the evaluation, the tell-and-sell interview can lead to defensiveness, resentment, and frustration on the part of the subordinate.

ISTOCK.COM/DILOK KLAISATAPORN

Performance feedback can help employees progress within an organization. A business usually evaluates its employees on an annual basis, but sometimes it does so quarterly or even monthly, especially when employees are newly hired. Performance reviews that gather feedback about employees from their peers, subordinates, and supervisors can help them get a realistic view of their strengths and weaknesses.

With the *tell-and-listen* approach, the supervisor tells the employee what the employee has done right and wrong and then gives him or her a chance to respond. The subordinate may simply be given an opportunity to react to the supervisor's statements or may be permitted to offer a full self-appraisal.

In the *problem-solving* approach, employees evaluate their own performance and set their own goals for future performance. The supervisor is more a colleague than a judge and offers comments and advice in a noncritical manner while mutually agreeing with the employee on goals for improvement. This is the method most likely to result in employee commitment to the established goals.

To avoid some of the problems associated with the tell-and-sell interview, supervisors sometimes use a mixed approach. The mixed interview uses the tell-and-sell approach to communicate administrative decisions and the problem-solving approach to discuss employee-development issues and future performance goals.

Another approach that has become popular is called a *360-degree evaluation*. A 360-degree evaluation collects anonymous reviews about employees from their peers, subordinates, and supervisors and compiles them into a feedback report for each employee. Companies that invest significant resources in employee-development efforts are especially likely to use 360-degree evaluations. Employees should not be given a feedback report without first having a one-on-one meeting with their supervisor. To ensure effective implementation, upper-level management should adopt this approach first and coach managers on how to use the feedback to achieve positive performance and behavioral outcomes.

Many managers find it difficult to discuss negative appraisals, leading them to ignore performance feedback. However, it is important for employees to be informed of how they can improve so that they can be their best. Employers should emphasize employee strengths when delivering a negative appraisal. Without feedback, employees may be unaware of their weaknesses and therefore not realize that they need to take steps to address them. Only through tactful, honest communication can the results of an appraisal be fully used.

✓ Concept Check

- What are the main objectives of performance appraisal?
- What methods are used?
- Describe the three approaches to performance feedback interviews.

9-9 Employee Turnover

Learning Objective

9-9 List common forms of employee turnover and explain why firms should strive to minimize it.

Companies make huge investments in training and development and provide performance appraisals to help reduce employee turnover. **Turnover** occurs when employees leave their jobs—whether they quit, retire, are laid off or fired, or even are promoted to a higher level within the firm. Regardless of why an employee leaves, they likely will have to be replaced or other employees will have to take over the tasks that employee once did. Understaffed firms often require other employees to take up the slack in the form of longer hours and overtime, which can lead to dissatisfaction and even more turnover. High levels of turnover are undesirable because recruiting, selecting, and training new employees is a costly process. Moreover, high turnover can stifle productivity and focus. Finally, high turnover can indicate a problem with morale that should be addressed. Turnover therefore requires careful monitoring by human resources personnel to minimize disruptions, reduce costs, and maximize overall employee satisfaction.

Undesirable turnover is primarily due to **terminations**, which are involuntary separations from a firm. When there is a mismatch between a firm's supply of and demand for human resources or a significant reduction in resources is needed to survive, it may need to consider **downsizing** by eliminating positions. In such cases, a company may implement a hiring freeze, cut back employees' hours and/or benefits, or *lay off* some employees—dismiss them from the workforce until they are needed again. In the case of layoffs, it is the positions that are eliminated rather than the employees holding those positions. In the face of drastically reduced revenues during the COVID-19 pandemic, Airbnb was forced to downsize, laying off about 1,900 employees or 25 percent of its workforce. The travel company offered laid-off employees severance pay, a year's worth of health insurance, and equity in the firm.[23] Perhaps the most compassionate method for making personnel cutbacks is through attrition. *Attrition* is the normal reduction in the workforce that occurs when employees leave a firm due to retirement or finding a new job. *Early retirement* is another option for reducing workforce size. Under early retirement, people who are within a few years of retirement are permitted to retire ahead of schedule with full benefits. *Buyouts* are similar to early retirement in that employees are offered a severance package in order to leave their jobs. Buyouts typically offer a number of weeks of pay for every year an employee has worked plus a specified period of extension of benefits after the employee leaves. As a last resort, unnecessary employees are sometimes simply *fired* if cause can be found, such as failure to measure up to a specified performance standard or the terms of an employment contract. In such cases, companies must take care to document employees' performance and should give them warning that their performance is subpar long before a pink slip is handed out. However, because of its negative impact, this method generally is used only when absolutely necessary.

It is important to recognize that not all turnover is due to such unhappy events. Sometimes current employees are considered for *promotion* to higher-level positions. They may be considered for *transfer* from one position to another at the same level. While promotions and transfers create new openings that must be filled, generally everyone in the organization is happy that they have occurred.

turnover when employees leave their jobs

terminations involuntary separations

downsizing eliminating positions

✓ Concept Check

- What is turnover?
- Why is turnover potentially problematic?
- What are common types of turnover?

9-10 The Legal Environment of HRM

Learning Objective

9-10 Explore some of the major legal issues affecting human resources management.

Legislation regarding HRM practices has been passed mainly to protect the rights of employees, to promote job safety, and to eliminate discrimination in the workplace. The major federal laws affecting HRM are summarized in Table 9-2.

Table 9-2 Federal Legislation Affecting Human Resources Management

Law	Purpose
National Labor Relations Act (1935)	Established a collective-bargaining process in labor–management relations and the National Labor Relations Board (NLRB)
Fair Labor Standards Act (1938)	Established a minimum wage and an overtime pay rate for employees working more than 40 hours per week
Labor–Management Relations Act (1947)	Provides a balance between union power and management power; also known as the Taft–Hartley Act
Equal Pay Act (1963)	Specifies that men and women who do equal jobs must be paid the same wage
Title VII of the Civil Rights Act (1964)	Prohibits discrimination in employment practices based on sex, race, color, religion, or national origin
Age Discrimination in Employment Act (1967, 1986)	Prohibits personnel practices that discriminate against people aged 40 years and older. The 1986 amendment eliminated a mandatory retirement age
Occupational Safety and Health Act (1970)	Regulates the degree to which employees can be exposed to hazardous substances and specifies the safety equipment that the employer must provide
Employment Retirement Income Security Act (1974)	Regulates company retirement programs and provides a federal insurance program for retirement plans that go bankrupt
Worker Adjustment and Retraining Notification (WARN) Act (1988)	Requires employers to give employees 60 days notice regarding plant closure or layoff of 50 or more employees
Americans with Disabilities Act (1990)	Prohibits discrimination against qualified individuals with disabilities in all employment practices, including job-application procedures; hiring; firing; advancement; compensation; training; and other terms, conditions, and privileges of employment
Civil Rights Act (1991)	Empowers employees to sue employers for sexual discrimination and collect punitive damages
Family and Medical Leave Act (1993)	Requires an organization with 50 or more employees to provide up to 12 weeks of leave without pay on the birth (or adoption) of a child or if an employee or an employee's spouse, child, or parent is seriously ill
Affordable Care Act (2010)	Requires an organization with 50 or more employees to make health insurance available to employees or pay an assessment and gives employees the right to buy health insurance from another provider if an organization's health insurance is too expensive

9-10a Civil Rights Acts

Over the years, the United States has passed a number of civil rights laws to protect various groups of employees from discrimination during recruiting, selection, and promotion. The Equal Pay Act of 1963, for example, specifies that men and women who are doing equal jobs must be paid the same wage. Equal jobs are ones that demand equivalent effort, skill, and responsibility and are performed under the same conditions. Discrepancies in pay are legal if they can be attributed to differences in seniority, qualifications, or performance. In spite of having this law on the books for more than half a century, women and men are not treated equally in the workplace as we have already seen in this chapter. For example, there are just 37 female CEOs of *Fortune* 500 companies—just 7.4 percent—and women working full time still earn 85 cents for every dollar earned by men working in comparable jobs.[24]

Arguably the most far-reaching legislation is Title VII of the Civil Rights Act of 1964. It forbids organizations with 15 or more employees to discriminate in employee selection and retention on the basis of sex, race, color, religion, or national origin. The purpose of Title VII is to ensure that employers make personnel decisions on the basis of employee qualifications only. As a result of this act, discrimination in employment (especially against African Americans) has been reduced in this country.

Later civil rights legislation expanded the protections of Title VII. For example, the Civil Rights Act of 1991 facilitates an employee's suing and collecting punitive damages for sexual discrimination. Discriminatory promotion and termination decisions as well as on-the-job issues, such as sexual harassment, are covered by this act. The Age Discrimination in Employment Act, which was passed in 1967 and amended in 1986, specifically outlaws personnel practices that discriminate against people aged 40 years or older in companies with 20 or more employees. Also outlawed are company policies that specify a mandatory retirement age. Employers must base employment decisions on ability, not on a number. For example, California-based Jet Propulsion Laboratory (JPL) paid $10 million to settle Equal Employment Opportunity Commission (EEOC) charges that it laid off workers over the age of 40 and passed over older candidates for promotion in favor of younger, less qualified workers. The space agency also agreed to bring in an EEO monitor and a diversity director and to revise its policies and training regarding discrimination.[25]

A person who believes that they have been discriminated against can file a complaint with the EEOC, which oversees federal laws and regulations regarding discrimination in employment. If it finds that the person has, in fact, been the victim of discrimination, the commission can take legal action on their behalf.

9-10b **Affirmative Action**

Although civil rights legislation attempted to halt discrimination, some underrepresented groups, such as Blacks, Hispanics, women, and people with disabilities continue to experience inequalities in employment and pay. In an effort to address this imbalance, redress past wrongs, and improve access to education, the United States has tried to use *affirmative action* to improve opportunities for these groups. Affirmative action is not one law, but a series of executive orders issued by the president of the United States, beginning with John F. Kennedy. It applies to all employers with 50 or more employees holding federal contracts in excess of $50,000. It prescribes that such employers (1) actively encourage job applications from members of underrepresented groups and (2) hire qualified employees from underrepresented groups who are not fully represented in their organizations. Many firms that do not hold government contracts voluntarily take part in affirmative action.

9-10c **Employee Safety**

Although today's workplaces are safer than ever, that has not always been the case. A number of laws have been passed to ensure safe workplace conditions. Among the most important of these is the Occupational Safety and Health Act, passed in 1970. This law regulates the degree to which employees can be exposed to hazardous substances. It also specifies the safety equipment that an employer must provide. The Occupational Safety and Health Administration (OSHA) was created to enforce this act. Inspectors from OSHA investigate employee complaints regarding unsafe working conditions. They also make spot checks on companies operating in particularly hazardous industries, such as chemicals and mining, to ensure compliance with the law. A firm found to be in violation of federal standards can be heavily fined or shut down. Nonetheless, many people feel that issuing OSHA violations is not enough to protect workers from harm.

ISTOCK.COM/WAVEBREAKMEDIA

Focus on what employees and job candidates can do—not what they can't. The American Disabilities Act (ADA) requires businesses to make reasonable accommodations for applicants and employees with disabilities. The law is not the only reason why firms should hire and retain people with disabilities. Studies have shown that firms that do so experience positive business outcomes. Many manual and electronic devices are available today that can help people with disabilities work safely and productively. Something as small as slightly redesigning workstations can make it possible for people of all abilities to work in many jobs.

9-10d **Employees with Disabilities**

One of the most disadvantaged groups of workers in the United States is those with some kind of disability. The Americans with Disabilities Act (ADA) prohibits discrimination against qualified individuals with disabilities in all employment practices—including job-application procedures, hiring, firing, advancement, compensation, training, and other terms and conditions of employment. All private employers and government agencies with 15 or more employees are covered by the ADA. Defining who is a qualified individual with a disability is, of course, difficult. Depending on how *qualified individual with a disability* is interpreted, more than 50 million Americans can be included under this law.[26] Although pregnancy is not a disability, the ADA also requires employers to provide reasonable accommodation to employees who are pregnant. It also mandates that all businesses that serve the public must make their facilities accessible to people with disabilities.

The ADA not only protects individuals with obvious physical disabilities, but also safeguards those with less visible conditions such as heart disease, diabetes, epilepsy, cancer, AIDS, and mental illnesses. Because of this law, many organizations no longer require job applicants to pass physical examinations as a condition of employment.

Employers are required to provide employees who are disabled with reasonable accommodation. *Reasonable accommodation* is any modification or adjustment to a job or work environment that will enable a qualified employee with a disability to perform a central job function. Reasonable accommodation might mean making existing facilities accessible to and usable by wheelchair users, restructuring a job, modifying work schedules, acquiring or modifying equipment, providing qualified readers or interpreters, or changing training programs.

✓ Concept Check

- How does the Civil Rights Act influence the selection and promotion of employees?
- What is the Occupational Safety and Health Act?
- What is the purpose of the Americans with Disabilities Act?

Summary

9-1 Describe the major components of human resources management.

Human resources management (HRM) is the set of activities involved in acquiring, maintaining, and developing an organization's human resources. Responsibility for HRM is shared by specialized staff and line managers. HRM activities include human resources planning, job analysis, recruitment, selection, orientation, compensation, benefits, training and development, and performance appraisal.

9-2 Identify the steps in human resources planning.

Human resources planning consists of forecasting the human resources that a firm will need and planning a course of action to match supply with demand. A forecast of human resources supply must take into account both the present workforce and any changes that may occur within it. Replacement charts and skills inventories are tools that can aid in this planning.

9-3 Discuss workplace diversity and some of the challenges and opportunities associated with it.

Workplace diversity refers to the differences among people in a workforce owing to factors such as age, race, ethnicity, gender, sexual orientation, and ability. With an increasing number of women, immigrants, and people of color in the U.S. workforce, management is faced with challenges and competitive advantages. Some organizations have implemented diversity-related training programs to make the most of workplace diversity. With proper guidance and management, a diverse and inclusive organization can prove beneficial to all involved.

9-4 Explain the objectives and uses of job analysis.

Job analysis provides a job description and a job specification for each position within a firm. A job description is a list of the elements that make up a particular job. A job specification is a list of qualifications required to perform a job. Job analysis is used in evaluation and in the determination of compensation levels and serves as the basis for recruiting and selecting new employees.

9-5 Describe the processes of recruiting, selecting employees, and onboarding.

Recruiting is the process of attracting qualified job applicants. Candidates for open positions may be recruited from within or outside a firm. In the selection process, information about candidates is obtained from applications, résumés, tests, interviews, references, assessment centers, even online social networking sites. This information is used to select the most appropriate candidate for the job. Onboarding—the process of integrating new employees into the organization—involves welcoming them, helping them build relationships within the firm, providing training and tools to carry out their assignments, and most importantly, acclimating them to the firm's culture.

9-6 Examine decisions associated with employee compensation and benefits.

Compensation is the payment employees receive in return for their labor. In developing a system for paying employees, management must decide on the firm's general wage level (relative to other firms), the wage structure within the firm, and individual wages. Wage surveys and job analyses are useful in making these decisions. Employees may be paid hourly wages, salaries, or commissions. They also may receive incentive payments, lump-sum salary increases, and profit-sharing payments. Increasingly, companies are taking steps to close the gender wage gap. Employee benefits, which are nonmonetary rewards to employees, add about 30 percent to the cost of compensation. These may take the form of pay for time not worked, insurance, retirement programs, and/or perks. Flexible benefit plans let employees customize their benefits among offered options.

9-7 Explain the purposes and techniques of employee training and development.

Employee-training and management-development programs enhance the ability of employees to contribute to a firm. When developing a training program, the company should analyze training needs and then select appropriate training methods, such as on-the-job, simulations, classroom teaching, conferences and seminars, and/or e-learning. Because training is expensive, an organization should periodically evaluate the effectiveness of its training programs.

9-8 Discuss performance appraisal techniques and performance feedback.

Performance appraisal, or evaluation, is used to provide employees with performance feedback, to serve as a basis for distributing rewards, and to monitor selection and training activities. Both objective and judgmental appraisal techniques are used. Their results are communicated to employees through three performance feedback approaches: tell-and-sell, tell-and-listen, and problem solving.

9-9 List common forms of employee turnover and explain why firms strive to minimize it.

Turnover occurs when employees leave their jobs—they quit, retire, are laid off or fired, or are promoted to a higher level within the firm. Turnover requires monitoring by HR personnel to minimize disruptions, reduce costs, and maximize overall employee satisfaction. Turnover may be due to terminations, downsizing, lay-offs, attrition, early retirement, buyouts, firing, promotions, or transfers.

9-10 Explore some of the major legal issues affecting human resources management.

Legislation regarding HRM practices has been passed mainly to protect the rights of employees, to promote job safety, and to eliminate discrimination in the workplace.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

human resources management (HRM) (246)
human resources planning (248)
replacement chart (249)
skills inventory (249)
workplace diversity (250)
job analysis (252)
job description (252)
job specification (252)
recruiting (253)
selection (255)
onboarding (257)
orientation (257)
compensation (258)
compensation system (258)
wage survey (258)
job evaluation (258)
hourly wage (259)
salary (259)

commission (259)
incentive payment (259)
lump-sum salary increase (259)
profit sharing (260)
employee benefit (260)
flexible benefit plan (261)
employee training (262)
management development (262)
mentors (262)
performance appraisal (264)
turnover (267)
terminations (267)
downsizing (267)

Discussion Questions

1. In general, on what basis is responsibility for HRM divided between line and staff managers?
2. How is a forecast of human resources demand related to a firm's organizational planning?
3. How accurately can managers plan for future human resources needs?
4. What are the major challenges and benefits associated with a diverse workforce?
5. What are the advantages and disadvantages of external recruiting? Of internal recruiting?
6. How is a job analysis used in the process of job evaluation?
7. For some companies, onboarding and orientation are synonymous. How are they different?
8. Suppose that you have just opened a new Ford sales showroom and repair shop. Which of your employees would be paid wages, which would receive salaries, and which would receive commissions?
9. Are employee benefits really necessary? Why?
10. As a manager, what actions would you take if an operations employee with six years of experience on the job refused ongoing training and ignored performance feedback?
11. Why is it so important to provide feedback after a performance appraisal?
12. Why are there so many laws relating to HRM practices?
13. Of the laws discussed in the text, which are the most important, in your opinion?

Case 9

Taco Bell Tackles Large-Scale Recruitment

With intense competition in the fast-food space, Taco Bell has leaned into innovation as a way to stand out with new restaurant concepts, delivery services, creative menu partnerships, and plant-based offerings. The Mexican-inspired fast-food restaurant is not only innovating its restaurant concepts and menu, but it's also finding new ways to enhance the restaurant employee experience with new approaches to recruitment and retention through its "Start With Us, Stay With Us" platform.

Taco Bell is innovating its external recruiting efforts. The restaurant company shows job candidates it's the life of the party by putting on an event of its own: summer hiring parties. During the summer months, Taco Bell recruiting ramps up as it works to match employee supply with forecasted demand. To fill thousands of jobs, the company hosted nearly 600 hiring parties—its take on a career fair—complete with free food, festivities, and on-the-spot job interviews at various restaurant locations. Taco Bell considers this large-scale recruitment effort to be an effective way to give candidates a glimpse of the company's fun-loving culture and the opportunity to interview in a casual environment. Though the primary objective is to recruit seasonal help, the company also hopes some of the new hires will become long-term employees. The company promoted the recruiting event through public relations, in-store signage, and social media.

The career fair events are part of a broader initiative to create new jobs in the United States. Even during the COVID-19 pandemic, when many retailers and restaurants laid off employees, Taco Bell forecasted more team members would be necessary as more consumers chose drive-through dining restaurants. The company committed to hiring more than 30,000 workers to fill traditional team member roles as well as new roles related to enhancing safety measures and social distancing requirements. To effectively hire this large number of workers, Taco Bell conducted virtual and curbside interviews.

Taco Bell's employees will experience a variety of changes as the company invests in new restaurant concepts. For example, Taco Bell's Go Mobile prototype restaurant is built around digital transactions. The stores are much smaller than the restaurant's traditional footprint with a double drive-through lane that features a dedicated pick-up option for app users. Employees will benefit from smart technology in the kitchen that syncs with the Taco Bell app. Taco Bell will also introduce so-called bellhops to streamline the drive-through experience. These employees will utilize handheld tablets to increase efficiency.

Taco Bell has also invested in technology to improve communication with frontline employees. For example, Taco Bell partnered with Crew to rapidly roll out its messaging and scheduling app at 470 corporate locations and more than 4,500 franchise locations. The app made real-time communication to team members a reality and streamlined workflows, syncing the company's various scheduling systems. The Crew app proved to be an asset during the global pandemic as franchisees were able to send critical top-down communications and maintain business continuity amid rapidly shifting safety procedures.

Taco Bell's "Start With Us, Stay With Us" platform is more than a slogan, it's a mentality. The company wants to provide career paths and educational opportunities for team members to contribute to their future success. This approach to recruitment and retention has changed the restaurant employee experience and stands to create employee advocates and attract talent that will be with the company long term.[27]

Questions

1. How has Taco Bell innovated its external recruiting efforts?
2. How has technology improved communication with employees?
3. Describe how Taco Bell devised a course of action for matching employee supply with demand during the summer months.

Building Skills for Career Success

1. Social Media Exercise

LinkedIn (www.linkedin.com) is the largest and best-known social network for professionals. Many of you are probably already familiar with it.

1. Do you have a profile? If not, you might want to consider developing one because many companies recruit from LinkedIn, and it can be a great tool for professional networking.
2. If you already have a profile, think about how you might improve it. Do you participate in discussion groups? Have you reached out and connected to people in industries where you want to work?

2. Building Team Skills

The New Therapy Company is soliciting a contract to provide five nursing homes with physical, occupational, speech, and respiratory therapists. The therapists will rotate among the five nursing homes. The therapists have not yet been hired, but the nursing homes expect them to be fully trained and ready to go to work in three months. The previous therapy company lost its contract because of high staff turnover owing to employee "burnout" (a common problem in this field), high costs, and low-quality care. The nursing homes want a plan specifying how the New Therapy Company will meet staffing needs, keep costs low, and provide high-quality care.

Assignment

1. Working in a group, discuss how the New Therapy Company can meet the deadline and still ensure a high quality of care. Also discuss the following:
   a. How many of each type of therapist will the company need?
   b. How will it prevent therapists from burning out?
   c. How can it retain experienced staff and still limit costs?
   d. Are promotions available for staff? What does the career ladder look like?
   e. How will the company manage therapists at five different locations? How will it keep in touch with them (computer, voice mail, or monthly meetings)? Would it make more sense to have therapists work permanently at each location rather than rotate among them?
   f. How will the company justify the travel costs? What other expenses might it expect?
2. Prepare a plan for the New Therapy Company to present to the nursing homes.

3. Researching Different Careers

A résumé provides a summary of your skills, abilities, and achievements. It also may include a description of the type of job you want. An effective résumé clearly communicates your career objectives, your experience and qualifications, and shows that you have given serious thought to your career.

Assignment

1. Prepare a résumé for a job that you want using the information in Online-Only Chapter 17 (see text website).
   a. Determine your skills and decide which are important for this particular job.
   b. Decide which format—chronological or functional—will be most effective in presenting your skills and experience.
   c. Keep the résumé to one page, if possible (no more than two pages). Note that portfolio items may be attached for certain jobs, such as artwork.
2. Have several people review the résumé for accuracy.
3. Ask your instructor to comment on your résumé.

Chapter 10

ISTOCK.COM/SHIRONOSOV

Motivating and Satisfying Employees

Why Should You Care?

As you move up into management positions or operate your own business, you will need to understand what motivates others in an organization.

Learning Objectives

Once you complete this chapter, you will be able to:

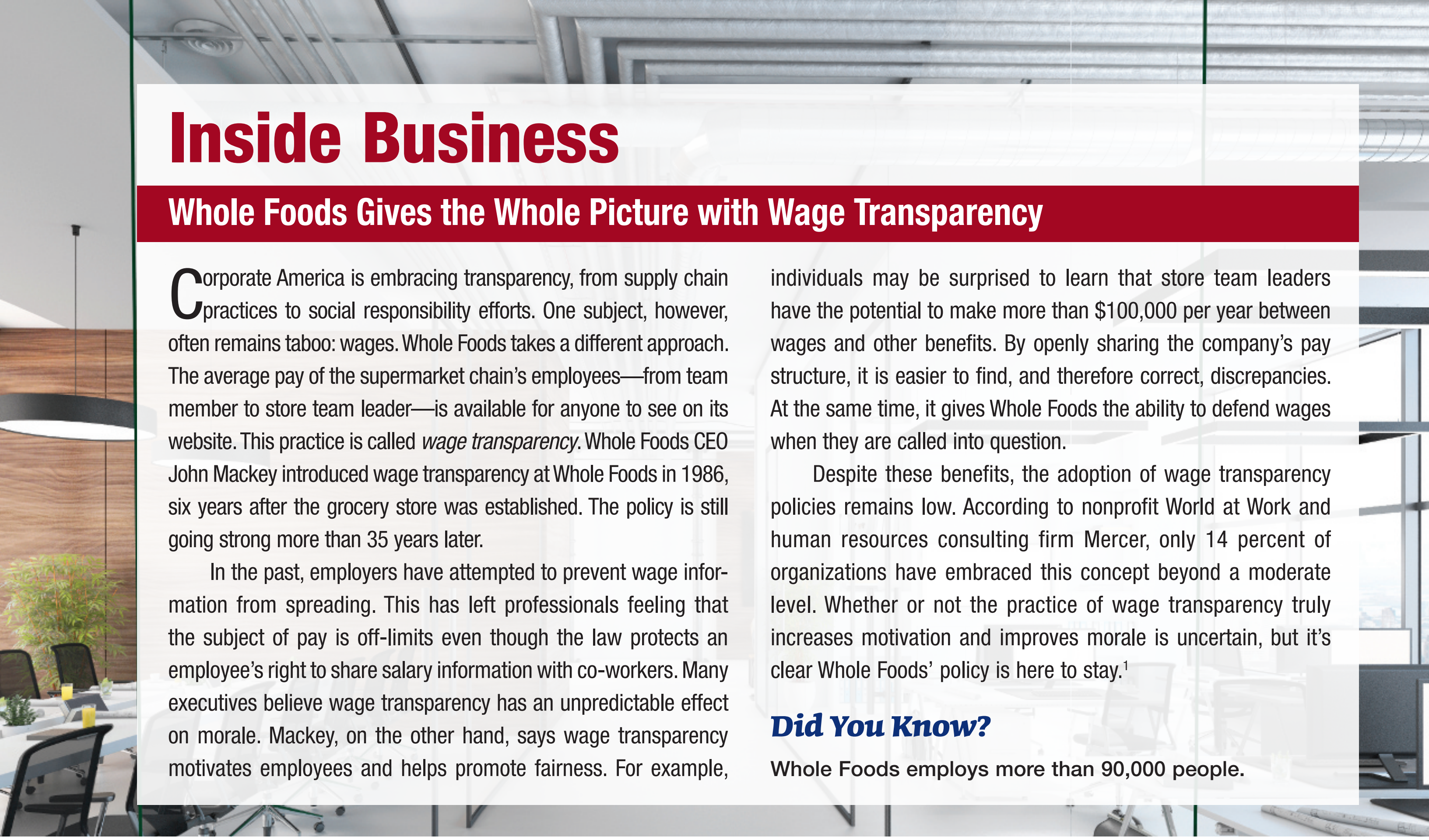
10-1 Explain motivation and its importance.

10-2 Describe some major historical perspectives on motivation.

10-3 Explore three contemporary views of motivation: equity theory, expectancy theory, and goal-setting theory.

10-4 Discuss the effects of organizational culture on employee performance.

10-5 Explain several techniques for increasing employee motivation.



Inside Business

Whole Foods Gives the Whole Picture with Wage Transparency

Corporate America is embracing transparency, from supply chain practices to social responsibility efforts. One subject, however, often remains taboo: wages. Whole Foods takes a different approach. The average pay of the supermarket chain's employees—from team member to store team leader—is available for anyone to see on its website. This practice is called *wage transparency*. Whole Foods CEO John Mackey introduced wage transparency at Whole Foods in 1986, six years after the grocery store was established. The policy is still going strong more than 35 years later.

In the past, employers have attempted to prevent wage information from spreading. This has left professionals feeling that the subject of pay is off-limits even though the law protects an employee's right to share salary information with co-workers. Many executives believe wage transparency has an unpredictable effect on morale. Mackey, on the other hand, says wage transparency motivates employees and helps promote fairness. For example, individuals may be surprised to learn that store team leaders have the potential to make more than $100,000 per year between wages and other benefits. By openly sharing the company's pay structure, it is easier to find, and therefore correct, discrepancies. At the same time, it gives Whole Foods the ability to defend wages when they are called into question.

Despite these benefits, the adoption of wage transparency policies remains low. According to nonprofit World at Work and human resources consulting firm Mercer, only 14 percent of organizations have embraced this concept beyond a moderate level. Whether or not the practice of wage transparency truly increases motivation and improves morale is uncertain, but it's clear Whole Foods' policy is here to stay.[1]

Did You Know?

Whole Foods employs more than 90,000 people.

To achieve its goals, any organization—be it Whole Foods, a local food truck, or a nonprofit organization—must be sure that its employees have more than the right raw materials, adequate facilities, and equipment that works. The organization also must ensure that its employees are *motivated*. A high level of employee motivation derives from effective management practices.

In this chapter, after first explaining what motivation is, we present several studies and views of motivation that have influenced management practices over the years: scientific management, Mayo's Hawthorne Studies, Maslow's hierarchy of needs, Herzberg's motivation–hygiene theory, McGregor's Theory X and Theory Y, Ouchi's Theory Z, and reinforcement theory. Then, turning our attention to contemporary theory, we examine equity, expectancy, and goal-setting theories. Next, we explore organizational culture and how it can influence employee performance. Finally, we discuss specific techniques managers can use to foster employee motivation and satisfaction.

motivation the individual internal process that energizes, directs, and sustains behavior; the personal "force" that causes you or me to behave in a particular way

10-1 What Is Motivation?

Learning Objective

10-1 Explain motivation and its importance.

A *motive* is something that causes a person to act. A successful athlete is said to be "highly motivated." A student who avoids work is said to be "unmotivated." We define **motivation** as the individual internal process that energizes, directs, and sustains behavior. It is the personal "force" that causes you or me to act in a particular way. For example, although job rotation may increase your job satisfaction and your enthusiasm for your work so that you devote more energy to it, it may not have the same impact on someone else.

Morale is an employee's attitude or feelings about the job, about superiors, and about the firm itself. To achieve organizational goals effectively, employees need more than the right raw materials, adequate facilities, and efficient equipment. High morale results mainly from the satisfaction of needs on the job or as a result of doing the job. One need that might be satisfied on the job is the need *to be recognized* as an important contributor to the organization. A need satisfied as a result of the job is the need for *financial security*. High morale leads to dedication, loyalty, and a desire to do the job well. Low morale, however, can lead to shoddy work, absenteeism, and high turnover rates as employees leave to seek more satisfying jobs with other firms. Turnover can be very costly. To minimize it, companies may try to create work environments that increase employee satisfaction. One obvious indicator of satisfaction at a specific organization is whether employees report that they like working there and whether other people want to work there. In a recent list of *Fortune* magazine's "Top 100 Companies to Work For," the top ten best companies to work for were Hilton, Ultimate Software, Wegmans Food Markets, Cisco, Workday, Salesforce, Edward Jones, Stryker, American Express, and Kimpton Hotels & Restaurants.[2] Motivation, morale, and the satisfaction of employees' needs are highly intertwined considerations. Their relationships to business success and productivity have been the subject of much study since the end of the 19th century. We continue our discussion of motivation by outlining some landmarks of the early research.

✓ Concept Check

- What is motivation?
- Why is understanding motivation important?

10-2 Historical Perspectives on Motivation

Learning Objective

10-2 Describe some major historical perspectives on motivation.

Researchers often begin a study with a fairly narrow goal in mind, usually to test a specific hypothesis. After they develop an understanding of their subject, however, they sometimes realize that their research has broader applications. This is exactly what happened when early research into productivity grew into the study of employee motivation.

10-2a Scientific Management

Toward the end of the 19th century, several engineers became interested in improving the efficiency of individual workers. Industrial engineers Frank and Lillian Gilbreth used filmed motion studies to identify efficiency improvements in work movements that could benefit employee wellbeing and motivation. Frederick W. Taylor, an American mechanical engineer, sought to identify efficiencies due to his own experiences in manufacturing plants. Their studies eventually led to the development of **scientific management**, the application of scientific principles to management of work and workers.

One of Taylor's first jobs was with the Midvale Steel Company in Philadelphia, where he developed a strong distaste for waste and inefficiency. While there, he observed a practice he dubbed "soldiering." Workers "soldiered," or worked slowly, because they feared that if they worked faster, they would run out of work and lose their jobs. Taylor realized that workers could get away with this because managers had no idea what productivity levels *should* be.

After Midvale, Taylor spent several years at Bethlehem Steel. While there, he made his most significant contribution to the field of motivation. He suggested that each job be broken down into separate tasks. Then management should determine (1) the best way to perform each task and (2) the job output to expect when employees performed the tasks properly. Next, management should choose the best person for each job and train that person in doing the job properly. Finally, management should monitor workers to ensure that jobs were performed as planned.

Taylor also developed the idea that most people work only to earn money. He therefore reasoned that pay should be tied directly to output. The more a

morale an employee's feelings about the job, about superiors, and about the firm itself

scientific management the application of scientific principles to management of work and workers worker produces, the more the worker should be paid. This gave rise to the *piece-rate system*, under which employees are paid a certain amount for each unit of output they produce. Under Taylor's piece-rate system, each employee is assigned an output quota. If they exceed the quota, they receive a higher per unit rate for all work produced (refer to Figure 10-1).

When Taylor's system was put into practice at Bethlehem Steel, the results were dramatic. Average earnings per day for steel handlers rose from $1.15 to $1.88. (Do not let the low wages obscure the fact that this was an increase of more than 61 percent!) The average amount of steel handled per day increased from 16 to 57 tons. Today, the piece-rate system is still used by some manufacturers and by farmers who grow crops that are harvested by farm laborers.

The Gilbreths' and Taylor's revolutionary ideas had a profound impact on management practice. However, their views of motivation were soon recognized as overly simplistic and narrow. It is true that most people expect to be paid for their work, but it is also true that people work for a variety of reasons other than pay. Therefore, simply increasing a person's pay may not increase that person's motivation or productivity.

ISTOCK.COM/BLUE PLANET STUDIO

Is anyone happy? Historically, most businesses in the United States weren't overly concerned about employee satisfaction. This is not the case today. Why do you think attitudes about employee motivation and satisfaction have changed?

10-2b The Hawthorne Studies

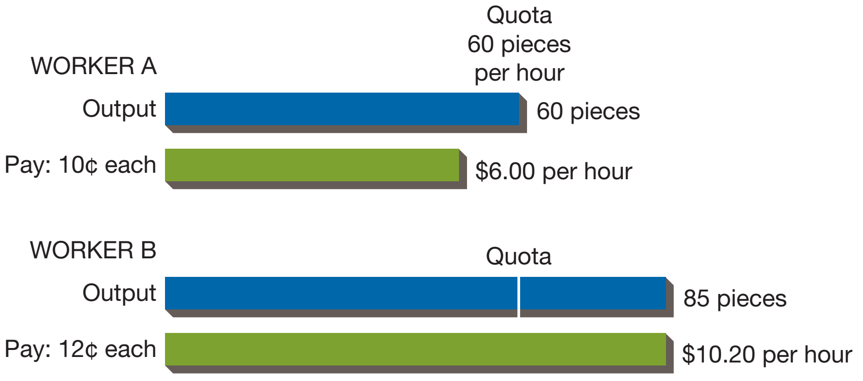
Between 1927 and 1932, Elton Mayo, an Australian sociologist and organizational theorist, conducted two experiments at the Hawthorne plant of the Western Electric Company in Chicago. The original objective of these studies, now referred to as the *Hawthorne Studies*, was to determine the effects of the work environment on employee productivity.

The first set of experiments tested the effect of lighting levels on productivity. One group of workers was subjected to varying lighting, while a second was not. To the amazement of the researchers, productivity increased for both groups. For the group whose lighting was varied, productivity remained high until the light was reduced to the level of moonlight!

The second set of experiments focused on the effectiveness of the piece-rate system in increasing the output of groups of workers. Researchers expected that

Figure 10-1 **Taylor's Piece-Rate System**

Workers who exceeded their quotas were rewarded with a higher rate per piece for all the pieces they produced.



output would increase because faster workers would put pressure on slower workers to produce more. Again, the results were not as expected. Output remained constant irrespective of the "standard" rates management set.

When faced with unexpected outcomes, the researchers concluded that *human factors* were responsible for the results. In the lighting experiments, researchers had given both groups of workers a *sense of involvement* in their jobs merely by asking them to participate in the research. These workers—perhaps for the first time—felt as though they were an important part of the organization. The level of light did not matter. In the piece-rate experiments, each group of workers informally set the acceptable rate of output for the group. To gain or retain the *social acceptance* of the group, each worker felt pressure to produce at the same rate as the group pace.

The Hawthorne Studies showed that such human factors are at least as important to motivation as pay rates. From these and other studies, the *human relations movement* in management was born. **Human relations** is the study of people and groups in the workplace and what motivates them to achieve organizational goals. The premise of the human relations movement was simple: Employees who are happy and satisfied with their work are motivated to perform better. Hence, management is best served by providing a work environment that maximizes employee satisfaction.

10-2c **Maslow's Hierarchy of Needs**

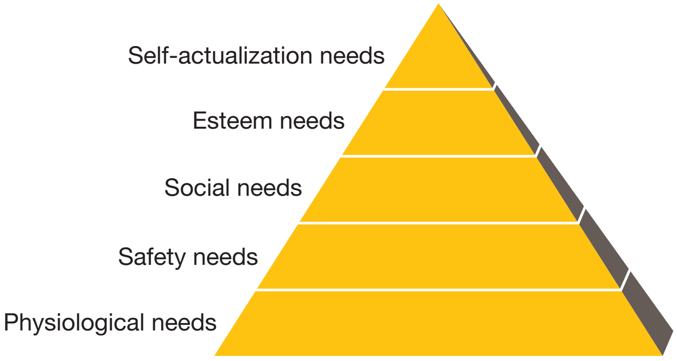
Abraham Maslow, an American psychologist whose best-known works were published in the 1960s and 1970s, developed a theory of motivation based on a hierarchy of needs. A *need* is a personal requirement. Maslow assumed that humans are "wanting" beings who seek to fulfill a variety of needs, which he argued can be arranged from most basic to most complex in a sequence now known as **Maslow's hierarchy of needs** (refer to Figure 10-2).

At the bottom of the pyramid are *physiological needs,* the things we require to survive. They include food and water, clothing, shelter, and sleep. In the employment context, these needs usually are satisfied through adequate wages.

At the next level are *safety needs,* the things we require for physical and emotional security. Safety needs may be satisfied through job stability, health insurance, pension plans, and safe working conditions. The escalating costs of healthcare in today's work environment threaten some workers' sense of safety. Many firms are switching to more part-time workers for low-wage positions in order to avoid health insurance costs and fees. The move might backfire as employees seek to satisfy their safety needs at more secure jobs. On the other hand, some companies strive to stand out by offering benefits that satisfy safety needs even to part-time employees. One such company is Starbucks, which offers part-time employees healthcare coverage and the opportunity to participate in a 401(k) retirement plan as long as they work

Figure 10-2 **Maslow's Hierarchy of Needs**

Psychologist Abraham Maslow believed that people act to fulfill five categories of needs.



human relations the study of people and groups in the workplace and what motivates them to achieve organizational goals

Maslow's hierarchy of needs a sequence of human needs in the order of their importance at least 20 hours per week. The company also offers paid leave, education tuition assistance, transit passes, and, of course, free coffee.[3]

Next are the *social needs,* the human requirements for love and affection and a sense of belonging. These needs are fulfilled in the workplace through the work environment and the informal organization and outside of the workplace by family and friends. At Colorado-based real estate firm East West Partners, for example, employees can join company kickball, softball, and snowshoe-running games and go on trips together.[4] Employers are increasingly offering their workers flexible scheduling options in order to improve their quality of life, which includes time for family and friends. Employees who have flexible work schedules are more likely to be able to attend family events or care for children or aging relatives. Employers can help workers satisfy social needs by providing useful feedback and fostering workplace cooperation and communication through a variety of media.

At the level of *esteem needs,* we require respect and recognition from others and a sense of our own accomplishment and worth (self-esteem). These needs may be satisfied through personal accomplishment, promotion to positions with greater responsibility, various honors and awards, and other forms of recognition.

At the top of the hierarchy are the *self-actualization needs,* which are the need to grow, develop, and become all that we are capable of being. These are the most difficult needs to satisfy, and the means of satisfying them tend to vary with the individual. For some people, learning a new skill, starting a new career after retirement, or trying to become the best at some endeavor may be the way to realize self-actualization. Some companies reimburse employees for continuing education expenses—even another college degree—knowing they get the benefit of employees with more knowledge as well as more satisfied employees who feel supported in their efforts to improve themselves.

Maslow suggested that people work up the hierarchy, satisfying their physiological needs before safety needs, for example. However, needs at one level do not have to be satisfied completely before needs at the next higher level come into play. People can also move up and down the hierarchy. For example, if a person loses a good job, he may find himself trying to satisfy safety needs when he only recently had focused on social needs.

Maslow's hierarchy of needs provides a guide for management and a useful way of viewing employee motivation. By and large, American business has been able to satisfy workers' basic needs, but the higher-order needs present more of a challenge. The means of satisfying these needs varies from one employee to another.

10-2d **Herzberg's Motivation-Hygiene Theory**

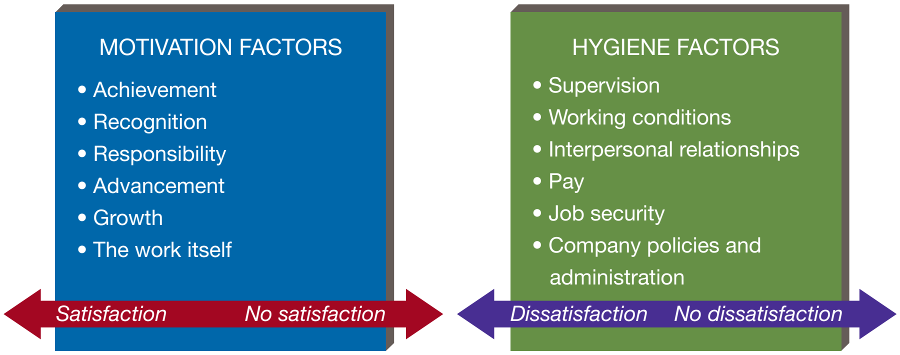
Frederick Herzberg, an American psychologist, interviewed approximately 200 accountants and engineers in Pittsburgh in the 1950s to develop his theory of motivation. He asked them to think of a time when they had felt especially good about their jobs and their work and to describe the factor or factors that had caused them to feel that way. Next, he asked them about a time when they had felt especially bad about their work. He was surprised to find that feeling good and feeling bad resulted from entirely different factors. That is, low pay may make a particular person feel bad, but high pay does not necessarily make that same person feel good.

Satisfaction and Dissatisfaction Before Herzberg's interviews, the general assumption was that employee satisfaction and dissatisfaction lay at opposite ends of the same scale. However, Herzberg's interviews convinced him that satisfaction and dissatisfaction are different dimensions altogether. In other words, the opposite of satisfaction is not dissatisfaction. The idea that satisfaction and dissatisfaction are separate and distinct dimensions is referred to as the **motivation-hygiene theory** (refer to Figure 10-3).

motivation-hygiene theory
the idea that satisfaction and dissatisfaction are separate and distinct dimensions

Figure 10-3 Herzberg's Motivation-Hygiene Theory

Herzberg's theory takes into account that there are different dimensions to job satisfaction and dissatisfaction and that these factors do not overlap.



The job factors that Herzberg found most frequently associated with satisfaction were achievement, recognition, responsibility, advancement, growth, and the work itself. These factors generally are referred to as **motivation factors** because their presence increases motivation. However, their absence does not necessarily result in dissatisfaction. When motivation factors are present, they act as *satisfiers*.

Dissatisfaction, on the other hand, is caused by job factors such as supervision, working conditions, interpersonal relationships, pay, job security, company policies, and administration. These factors, called **hygiene factors**, reduce dissatisfaction when they are present to an acceptable degree. However, they do not necessarily result in high levels of motivation. When hygiene factors are absent, they act as *dissatisfiers*.

motivation factors job factors that increase motivation, although their absence does not necessarily result in dissatisfaction

hygiene factors job factors that reduce dissatisfaction when present to an acceptable degree but that do not necessarily result in high levels of motivation

Using Herzberg's Motivation-Hygiene Theory Herzberg provides explicit guidelines for using the motivation-hygiene theory of employee motivation. He suggests that the hygiene factors must be present to ensure that a worker can function comfortably. He warns, however, that a state of *no dissatisfaction* cannot exist. In any situation, people always will be dissatisfied with something.

ISTOCK.COM/NATALIA SHABASHEVA

What satisfies employees? **Companies sometimes use travel awards as incentives for better employee performance. According to the motivation-hygiene theory, when an incentive for higher performance is not provided, is that a dissatisfier?**

According to Herzberg, managers should utilize hygiene factors to make the work environment as positive as possible, but should expect only short-term improvements in motivation. Managers must focus instead on providing those satisfiers that will enhance motivation and long-term effort.

We should note that employee pay has proven to have more effect than Herzberg's theory indicates. He suggests that pay provides only short term, not true, motivation. Yet, in many organizations, pay is a form of recognition and reward for achievement—and recognition and achievement are both motivation factors. The effect of pay may depend on how it is distributed. If a pay increase does not depend on performance (as in across-the-board or cost-of-living raises), it may not motivate people. However, if pay is increased as a form of recognition (as in bonuses or incentives), it can play a role in motivating employees to higher performance.

10-2e **Theory X and Theory Y**

ISTOCK.COM/PAPERKITES

The concepts of Theory X and Theory Y were advanced by Douglas McGregor, an American business professor, in his book, *The Human Side of Enterprise*, in 1967. They represent opposing sets of assumptions that underlie management's attitudes and beliefs regarding workers' behavior.

Theory X is a concept of employee motivation generally consistent with Taylor's ideas about scientific management. Theory X is based on the following assumptions:

1. People dislike work and try to avoid it.
2. Because people dislike work, managers must coerce, control, and frequently threaten employees to achieve organizational goals.
3. People generally must be led because they have little ambition and will not seek responsibility; they are concerned mainly about security.

The logical outcome of such assumptions will be a highly controlled, autocratic work environment—one in which managers make all the decisions and employees take all the orders.

On the other hand, **Theory Y** is a concept of employee motivation generally consistent with the ideas of the human relations movement. Theory Y is based on the following assumptions:

1. People do not naturally dislike work. In fact, work is an important part of all of our lives.
2. People will work toward goals to which they are committed.
3. People become committed to goals when it is clear that accomplishing the goals will bring personal rewards.
4. People often seek out and willingly accept responsibility.
5. Employees have the potential to help accomplish organizational goals.
6. Organizations generally do not make full use of their human resources.

Obviously, Theory Y is much more positive than Theory X. McGregor argued that most managers behave in accordance with Theory X, but he maintained that Theory Y is more appropriate and effective as a guide for managerial action (refer to Table 10-1).

The human relations movement and Theories X and Y increased managers' awareness of the importance of social factors in the workplace during the second half of the 20th century. However, human motivation is a complex and dynamic process to which there is no simple key. It is clear from decades of research that neither money nor social factors alone can provide the answer.

Table 10-1 **Theory X and Theory Y Contrasted**

Area	Theory X	Theory Y
Attitude toward work	Dislike	Involvement
Control systems	External	Internal
Supervision	Direct	Indirect
Level of commitment	Low	High
Employee potential	Ignored	Identified
Use of human resources	Limited	Not limited

Theory X a concept of employee motivation generally consistent with Taylor's scientific management; assumes that employees dislike work and will function only in a highly controlled work environment

Theory Y a concept of employee motivation generally consistent with the ideas of the human relations movement; assumes responsibility and work toward organizational goals, and by doing so employees also achieve personal rewards

10-2f **Theory Z**

William Ouchi, a management professor at UCLA, studied business practices in American and Japanese firms as discussed in his book, *Theory Z: How American Management Can Meet the Japanese Challenge*. He concluded that different types of management systems dominate in these two countries. In Japan, Ouchi found what he calls *type J* firms. They are characterized by lifetime employment, collective (or group) decision making, collective responsibility for the outcomes of decisions, slow evaluation and promotion, implied control mechanisms, nonspecialized career paths, and a holistic concern for employees as people.

American industry is dominated by what Ouchi calls *type A* firms, which follow a different pattern. They emphasize short-term employment, individual decision making, individual responsibility for the outcomes of decisions, rapid evaluation and promotion, explicit control mechanisms, specialized career paths, and a segmented concern for employees only as employees.

A few very successful American firms represent a blend of the type J and type A patterns. These firms, called *type Z* organizations, emphasize long-term employment, collective decision making, individual responsibility for the outcomes of decisions, slow evaluation and promotion, informal control along with some formalized measures, moderately specialized career paths, and a holistic concern for employees.

Ouchi's **Theory Z** posits that some middle ground between his type A and type J practices is best for American business (refer to Figure 10-4). A major part of Theory Z emphasizes participative decision making. The focus is on "we" rather than on "us versus them." Theory Z employees and managers view the organization as a family. This participative spirit fosters cooperation and encourages the dissemination of information and organizational values.

10-2g **Reinforcement Theory**

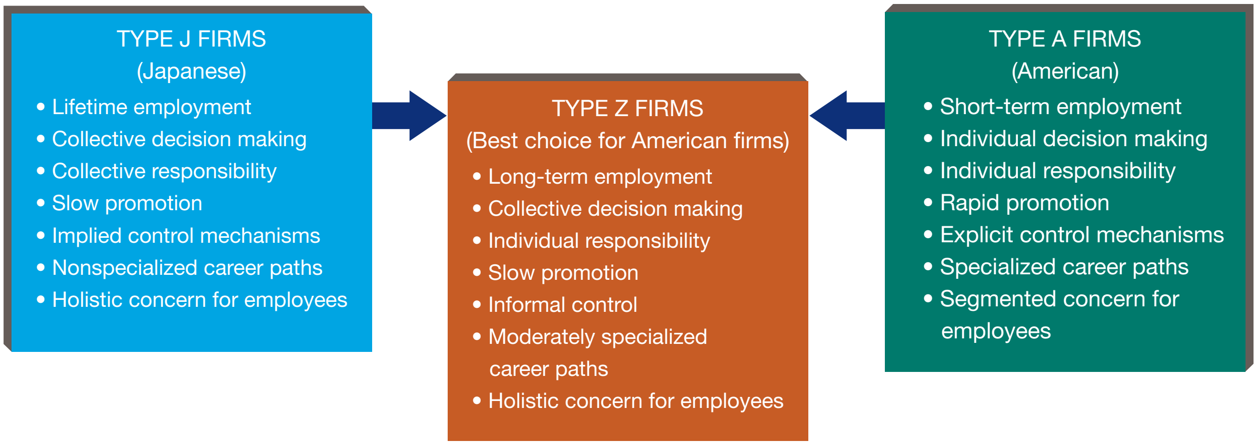
Reinforcement theory is based on the premise that people will repeat behavior that is rewarded and will cease behavior that is punished. A *reinforcement* is an action that follows directly from a particular behavior. It may be a pay raise after a particularly large sale to a new customer or a reprimand for coming late to work.

Theory Z a concept of management which emphasizes participative decision making, with a holistic concern for employees

reinforcement theory a theory of motivation based on the premise that rewarded behavior is likely to be repeated, whereas punished behavior is less likely to recur

Figure 10-4 The Features of Theory Z

The best aspects of Japanese and American management theories combine to form the nucleus of Theory Z.


TYPE J FIRMS
(Japanese)
• Lifetime employment
• Collective decision making
• Collective responsibility
• Slow promotion
• Implied control mechanisms
• Nonspecialized career paths
• Holistic concern for employees
TYPE Z FIRMS
(Best choice for American firms)
• Long-term employment
• Collective decision making
• Individual responsibility
• Slow promotion
• Informal control
• Moderately specialized career paths
• Holistic concern for employees
TYPE A FIRMS
(American)
• Short-term employment
• Individual decision making
• Individual responsibility
• Rapid promotion
• Explicit control mechanisms
• Specialized career paths
• Segmented concern for employees

Reinforcements can take a variety of forms and can be used in a number of ways. A *positive reinforcement* is one that strengthens desired behavior by providing a reward, such as praise or recognition from supervisors for a job done well. A reward increases (strengthens) one's willingness to perform well in the future. A *negative reinforcement* strengthens desired behavior by eliminating an undesirable task or situation. Suppose that a machine shop must be cleaned thoroughly every month—a dirty, miserable task. During a month when the workers do a less-than-satisfactory job, the boss requires them to clean the factory themselves, rather than bringing in the usual private maintenance service. The employees will be motivated to work harder the next month to avoid the unpleasant cleanup duty.

Punishment is a consequence of undesirable behavior. Common forms of punishment used in organizations include reprimands, reduced pay, disciplinary layoffs, and termination (firing). Punishment often does more harm than good by creating a negative work environment, fostering worker hostility, and encouraging employees to engage in undesirable behaviors behind the backs of supervisors.

Managers who rely on *extinction* hope to eliminate undesirable behavior by not responding to it with the hope that the behavior will eventually go "extinct." Suppose, for example, that an employee writes memo after memo to his or her manager about insignificant events. If the manager does not respond to any of these memos, the employee probably will stop writing them, and the behavior will stop.

The effectiveness of reinforcement depends on which type is used and how it is timed. Some situations lend themselves to the use of more than one approach. Generally, positive reinforcement is considered the most effective with most employees, and it is recommended when the manager has a choice.

Continual reinforcement can become tedious for both managers and employees, especially when the same behavior is being reinforced over and over again in the same way. At the start, it may be necessary to reinforce a desired behavior every time it occurs. Generally, once a desirable behavior has been more or less established, only occasional reinforcement will be needed.

✓ Concept Check

- What are the major elements of Taylor's "scientific management"?
- What were Elton Mayo's conclusions from the Hawthorne Studies?
- What are the different levels in Maslow's hierarchy of needs?
- What are the major elements of Herzberg's motivation-hygiene theory?
- What are the underlying assumptions of Theory X and Theory Y?

10-3 Contemporary Views of Motivation

Learning Objective

10-3 Explore three contemporary views of motivation: equity theory, expectancy theory, and goal-setting theory.

Maslow's hierarchy of needs and Herzberg's motivation-hygiene theory are popular and widely known theories of motivation. Each takes a broader view than the narrow focus of scientific management and Theories X and Y. However, they do have a weakness: each attempts to specify *what* motivates people, but neither explains *why* or *how* motivation develops or is sustained over time. More recently, managers have explored three other models that take a more dynamic view of motivation. These are equity theory, expectancy theory, and goal-setting theory.

10-3a Equity Theory

The **equity theory** of motivation is based on the premise that people are motivated to obtain and preserve equitable treatment for themselves. As used here, *equity* is the distribution of rewards in direct proportion to each employee's contribution to the organization. Everyone need not receive the same rewards, but the rewards should be in accordance with individual contributions.

According to this theory, we conceive of equity in the following way. First, we develop our own input-to-outcome ratio. *Inputs* are the time, effort, skills, education, experience, and so on that we contribute to the organization. *Outcomes* are the rewards we get from the organization, such as pay, benefits, recognition, and promotions. Next, we compare this ratio to what we perceive as the input-to-outcome ratio for some other person. It might be a co-worker, a friend who works for another firm, or even an average of all the people in our organization. This person is called the *comparison other*.

equity theory a theory of motivation based on the premise that people are motivated to obtain and preserve equitable treatment for themselves

JODI HILTON/NURPHOTO/GETTY IMAGES

Employees want to be treated fairly. Employees compare the amount of effort they put into their jobs and the outcomes they get to that of their co-workers. This is the idea behind equity theory. At sweatshops such as this one, though, all employees are treated unfairly. Does equity theory come into play in this instance?

Note that the important consideration is that we believe our perception to be correct, whether or not it is.

If the two ratios are roughly the same, we feel that the organization is treating us equitably. In this case, we are motivated to leave things as they are. However, if our ratio is the higher of the two, we feel under-rewarded and are motivated to make changes. We may (1) decrease our own inputs by not working as hard, (2) try to increase our outcome by asking for a raise in pay, (3) try to get the comparison other to increase some inputs or receive decreased outcomes, (4) leave the work situation, or (5) conduct a new comparison with a different comparison other.

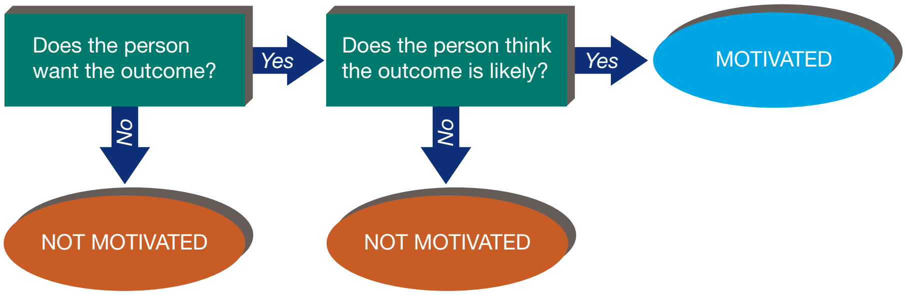
Equity theory is most relevant to compensation as an outcome. Because compensation is a very real measure of a person's worth to an organization, comparisons involving compensation are a natural part of organizational life. Managers can try to avoid problems arising from inequity by ensuring that rewards are distributed on the basis of performance and that everyone clearly understands the basis for their own pay.

10-3b **Expectancy Theory**

Expectancy theory, developed by Victor Vroom, a Canadian business professor, is a very complex model of motivation based on a simple assumption. According to expectancy theory, motivation depends on how much we want something and on how likely we think we are to get it (refer to Figure 10-5). Consider, for example, the case of three sales representatives who are candidates for promotion to one sales manager's job. Juan has had a very good sales year and always gets positive performance evaluations. However, he is not sure that he wants the job because it involves travel, long working hours, and stress and pressure. Paul wants the job badly, but does not think he has much chance of getting it. He has had a terrible sales year and gets only mediocre performance evaluations from his present boss. Sarah wants the job as much as Paul, and she thinks that she has a pretty good shot. Her sales have improved this past year, and her evaluations are the best in the company. Expectancy theory would predict that Juan and Paul are not very motivated to seek the promotion. Juan does not really want it, and Paul does not think that he has much of a chance of getting it. Sarah, however, is very motivated to seek the promotion because she wants it and thinks that she can get it.

Figure 10-5 **Expectancy Theory**

Vroom's theory is based on the idea that motivation depends on how much people want something and on how likely they think they are to get it.


Does the person want the outcome?
Yes
Does the person think the outcome is likely?
Yes
MOTIVATED
No
No
NOT MOTIVATED
NOT MOTIVATED

expectancy theory a model of motivation based on the assumption that motivation depends on how much we want something and on how likely we think we are to get it

Expectancy theory is complex because each action we take is likely to lead to several outcomes, some of which we want and others we do not. For example, a person who works hard and puts in many extra hours may get a pay raise, be promoted, and gain valuable new job skills. However, that person may also be forced to spend less time with his or her family and to cut back on social activities.

For one person, the promotion may be paramount, the pay raise and new skills fairly important, and the loss of family and social life of negligible importance. For someone else, the family and social life may be most important, the pay raise of moderate importance, the new skills unimportant, and the promotion undesirable because of the additional hours it would require. The first person would be motivated to work hard and put in the extra hours, whereas the second person would not be motivated at all to do so. In other words, it is the bundle of outcomes combined with the individual's perception of each outcome's importance that determines motivation.

Expectancy theory is difficult to apply, but it does provide several useful guidelines for managers. It suggests that managers must recognize that (1) employees work for a variety of reasons, (2) these reasons, or expected outcomes, may change over time, and (3) it is necessary to show employees how they can attain the outcomes they desire.

ISTOCK.COM/KHOSRORK

What do employees want? That's what their managers need to determine. Different employees are motivated by different rewards. Figuring out which rewards motivate each employee is a key step in goal setting.

10-3c Goal-Setting Theory

Goal-setting theory states that employees are motivated to achieve goals that they and their managers establish together. The goal should be very specific, moderately challenging, and one that the employee will be committed to achieve.[5] Rewards should be tied directly to goal achievement. Using goal-setting theory, a manager can design rewards that fit employee needs, clarify expectations, maintain equity, and provide reinforcement. For example, a manager might discover that one of her employees is very motivated by the occasional day off. Therefore, the manager and the employee may work out a plan that involves a free day as a reward after he completes a project satisfactorily and ahead of schedule, as long as he is up-to-date in his other work. This theory takes into account the goal the employee has to achieve and the rewards that will accrue if the goal is accomplished.

✓ Concept Check

- What is equity theory?
- How do managers use it in order to decide the pay structure of employees?
- What is expectancy theory and how is it different from goal-setting theory?

10-4 Organizational Culture

Learning Objective

10-4 Discuss the effects of organizational culture on employee performance.

One factor that plays a significant role in employee motivation is organizational, or corporate, culture. In fact, in a recent survey of 5,000 employees in the United States and Europe, more than half said they viewed corporate culture as more important than salary with regard to job satisfaction.[6] While it has been described in many ways, **organizational culture** can generally be defined as the inner rituals, traditions, processes, and values of a firm. Consider Southwest Airlines, which is known for its fun, friendly, people-first culture. The low-cost airline strives to hire people who share its values, pays them well, treats them fairly, and acknowledges their contributions to its success. In addition to generous compensation and benefits, the airline recognizes employees' efforts and milestones with special awards and celebrations. It also hosts fun companywide and local office festivities such as rallies and chili cook-offs. Southwest

goal-setting theory a theory of motivation suggesting that employees are motivated to achieve goals that they and their managers establish together

organizational culture the inner rituals, traditions, processes, and values of a firm

ISTOCK.COM/FG TRADE

Organizational culture. Corporate culture can influence whether and how employees celebrate special occasions.

has long recognized that satisfied, happy employees who feel valued will have a "Fun-LUVing Attitude" and deliver "Legendary Customer Service."[7] The company's strong culture helps it succeed in a very competitive industry and land routinely on "Most Admired Company" and "Best Company to Work for" lists.

Organizational culture exists in all organizations whether they are small businesses, large corporations, or nonprofit organizations. It includes both the formal rules and structure of a firm as well as informal and even unwritten norms, stories, rules, dress codes, and so on. While an organizational culture can influence public perception of an organization, it can also have a powerful influence on employee motivation, performance, and choices. Organizational culture also sets the tone for how managers view and treat workers.

When managers develop and nurture a culture that addresses the reasons why people work, employees are more likely to be motivated to work toward the organization's goals. Researchers have identified six core reasons why people want to work: play, purpose, potential, emotional pressure, economic pressure, and inertia. When firms foster a culture that allows employees to have a sense of play, fulfill their purpose, and/or develop their potential, employees are more likely to feel satisfied and therefore motivated to work to achieve organizational goals and satisfy customers. On the other hand, when companies create, purposefully or otherwise, a culture that subjects workers to emotional or economic pressure or allows them to suffer from inertia, performance may suffer

Exploring Careers

Vet Employer Values to Avoid an Early Exit

Finding the right company to work for can be a matter of finding the right cultural fit for you. Organizational culture provides alignment to the organization's vision, purpose, and goals. Because organizational culture has a powerful influence on an organization's employees, it's important to do your homework and research prospective employers.

When researching a prospective employer, explore the company's benefits such as healthcare, flexible work schedules, and discounts and identify the company's leadership team. A company's website and blog as well as its social media profiles can provide a wealth of information. During the interview, ask if there are different rules for different employees. This can reveal which people and actions the organization values most. If interviewing through a recruiter, ask them if they think you're the right fit. They may have valuable insight into why the individual vacated the role you're about to take. Lastly, request a tour and walk the halls of the potential employer. The way employees interact with a job candidate can be telling.

Employees are less likely to thrive in an incompatible corporate culture. According to a TopResume survey, job seekers say company culture is nearly as important as salary and bonuses when deciding which job offer to accept. Failing to vet employer values can lead to an early exit. Research the company's core mission and find a company with goals that resonate with your interests.

Sources: Based on information in "The Complete Guide to Researching a Company," *Indeed*, January 9, 2021, www.indeed.com/career-advice/finding-a-job/the-complete-guide-to-researching-a-company; Joann S. Lublin, "Considering a New Job? Beware a Culture Misfit," *The Wall Street Journal*, January 15, 2020, www.wsj.com/articles/considering-a-new-job-beware-a-culture-misfit-11579084201; Natalie Baumgartner, "Build a Culture That Aligns with People's Values," *Harvard Business Review*, April 8, 2020, www.hbr.org/2020/04/build-a-culture-that-aligns-with-peoples-values.

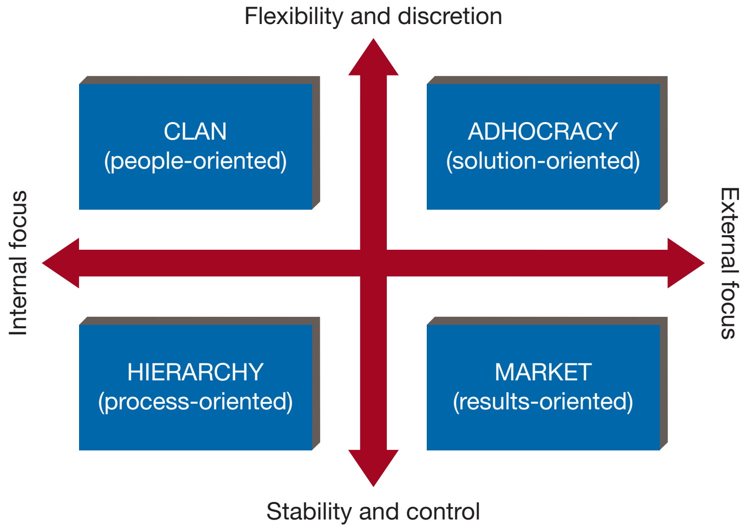
because employees are less motivated. Recall Southwest Airlines. When researchers studied the airline industry to measure the total motivation of employees at different airlines (as determined by assessing play, purpose, potential, emotional pressure, economic pressure, and inertia), they found that Southwest Airlines' employees scored very high relative to those of other airlines. Southwest also routinely earns some of the highest customer satisfaction scores in the industry.[8] Firms with strong cultures that motivate employees are likely to recruit better quality job candidates and experience reduced employee turnover and lower absenteeism, which is likely to translate to more satisfied customers and greater profitability.

Professors Robert Quinn and Kim Cameron identified four distinct types of organizational cultures (refer to Figure 10-6) based on two dimensions. They assess organizational cultures as being along a continuum of flexibility and discretion versus stability and control. Some organizations value stability and strive to impose it with strong control measures, while others value flexibility and allow employees discretion to achieve it. Quinn and Cameron also evaluate cultures as to the degree they are focused internally or externally. Based on these dimensions, Quinn and Cameron classify organizations into clan, adhocracy, hierarchy, or market culture types.[9]

The *clan culture* is characterized by a family-like structure that values loyalty, cohesion, and personal relationships within the firm. As we have already seen, Southwest Airlines is an example of a company with a clan structure. This structure is also common in smaller firms where a less formal culture evolves with employees looking out for each other and having a strong emotional investment in the firm and its mission.

The *adhocracy culture* is characterized by its risk-taking, problem-solving nature. Disruptive firms like Uber and Facebook often have adhocracy cultures that can be nimble in responding to changes in the environment and identifying underserved markets. Nike is another company with an adhocracy culture. Its design teams strive to "learn, fail fast, and keep moving" to research and find solutions for all kinds of athletes who want the most from their performance clothing. One such challenge they identified was Muslim women who want to swim and compete in swimming but could not find modest yet competitive swimwear. When Nike targeted this underserved group with a moisture-wicking hijab head covering, it was rewarded with strong sales. Buoyed by that success, Nike then spent several years developing

Figure 10-6 **Types of Organizational Cultures**



Source: Adapted from Kim S. Cameron and Robert E. Quinn, *Diagnosing and Changing Organizational Culture* (San Francisco: Jossey-Bass, 2006), p. 35.

a modesty swimsuit that provides full coverage as well as full mobility with style and practicality.[10]

The *market culture* is very results-oriented, which makes it well-suited for financial firms. Amazon and Apple also have market cultures. These firms tend to be very competitive and focus strongly on achieving market share and bottom-line objectives. It is worth noting, however, that a strong results orientation can push people into making less desirable choices in an effort to meet organizational goals.

Finally, the *hierarchical culture* is very formal with a traditional chain of command. These bureaucratic cultures value efficiency and stability and have strict rules and boundaries. It should come as no surprise that the hierarchical structure is very common in the military and many government agencies. However, this structure may be less nimble in responding to fast-changing business environments.

Regardless of what type of culture an organization has, managers need to recognize that culture can motivate employees and push them to achieve the organization's goals. They need to model their firms' values, enforce the formal rules, and nurture an environment that supports employees' ability to satisfy their needs and feel that their contributions are valued. A strong culture that satisfies and motivates employees in healthy ways can ensure their loyalty and effort and thereby inspire customer devotion. It is also important to recognize that organizational cultures evolve as companies grow and change. Managers need to monitor, communicate about, and guide these changes to ensure they do not negatively affect employee morale and motivation.

✓ Concept Check

- What is organizational culture?
- How can organizational culture promote employee motivation?
- Explain the four types of organizational cultures.

10-5 Key Motivation Techniques

Learning Objective

10-5 Explain several techniques for increasing employee motivation.

As we have seen, it takes more than a generous salary to motivate employees today. In addition to developing and nurturing rewarding organizational cultures, companies are increasingly trying to provide motivation by satisfying employees' less-tangible and changing needs. Businesses may use simple, low- or no-cost, or complex and expensive approaches to motivation. In this section, we discuss several specific techniques that help managers boost employee motivation and job satisfaction. The bottom line is that these approaches may help employees feel satisfied and valued—and thus more likely to remain with the organization.

10-5a Management by Objectives

Management by objectives (MBO) is a motivation technique in which managers and employees collaborate in setting goals. The primary purpose of MBO is to clarify the roles employees are expected to play in reaching the organization's goals. MBO increases employee motivation by empowering them with an active role in goal-setting and performance evaluation.

Most MBO programs consist of a series of five steps. The first step in setting up an MBO program is to secure the acceptance of top management. It is essential that top managers endorse and participate in the program if others in the firm are to accept it. This also provides a natural starting point for educating employees about the purposes and mechanics of MBO.

In the second step, top management and other parties must establish preliminary goals that reflect a firm's mission and strategy. The intent of an MBO program is to have these goals filter down through the organization.

The third step is the heart of MBO. It consists of the following three smaller steps:

1. The manager explains to every employee that they have accepted certain goals for the organization, or a group within the organization, and asks them to think about how they can help achieve these goals.

management by objectives (MBO) a motivation technique in which managers and employees collaborate in setting goals

2. The manager later meets with each employee individually. Together they establish individual goals for the employee. Whenever possible, the goals should be measurable and should specify the time frame for completion (usually one year).
3. The manager and the employee decide what resources the employee will need to accomplish his or her goals.

As the fourth step, the manager and employees meet periodically to review each employee's progress. They may agree to modify certain goals during these meetings if circumstances have changed. For example, a sales representative accepted a goal of increasing sales by 20 percent. However, an aggressive competitor has since entered the marketplace, making this goal unattainable. In light of this circumstance, the goal is revised down to 10 or 15 percent.

The fifth step in the MBO process is evaluation. At the end of the designated time period, the manager and each employee meet again to determine which of the individual's goals were met and which were not, and why. The employee's reward (in the form of a pay raise, praise, or promotion) is based primarily on the degree of goal attainment.

As with every other management method, MBO has advantages and disadvantages. MBO can motivate employees by involving them actively in the life of the firm. The collaboration on goal setting and performance appraisal improves communication and makes employees feel that they are an important part of the organization. Periodic progress reviews also enhance quality control within an organization. Shortcomings of MBO are that it must have the support of top management, it can result in a lot of paperwork, and managers may not like to work out goals with subordinates.

10-5b Job Enrichment

Job enrichment is a method of motivating employees by providing them with variety in their tasks while giving them some responsibility for, and control over, their jobs. At the same time, employees gain new skills and acquire a broader perspective about how their individual work contributes to the goals of the organization. Earlier in this chapter, we noted that Herzberg's motivation-hygiene theory is one rationale for the use of job enrichment. That is, the added responsibility and control that job enrichment confers on employees increases their satisfaction and motivation. For example, some employees at Microsoft, Apple, and Google have been allowed to spend a fraction of their time at work on projects of their choosing. This type of enrichment can motivate employees and result in benefits for the company. At times, **job enlargement**, expanding a worker's assignments to include additional but similar tasks, can lead to job enrichment. Job enlargement might mean that a worker on an assembly line who used to connect three wires to components moving down the line now connects five wires. Unfortunately, the added tasks often are just as routine as those the worker performed before the change and may not be an effective motivator over the long term.

Although job enlargement does not really change the routine and monotonous nature of jobs, job enrichment does. Job enrichment results in an increased sense of employee responsibility, increased control over how the job is performed, and new tasks. Job enrichment gives workers more authority and assigns tasks in complete, natural units (rather than breaking it down into the smallest possible task). Employees frequently are given fresh and challenging job assignments. By blending more planning and decision making into jobs, enrichment gives work more depth and complexity.

Job redesign is a type of job enrichment in which work is restructured in ways that cultivate the worker-job match. Job redesign can be achieved by

job enrichment a motivation technique that provides employees with more variety and responsibility in their jobs

job enlargement expanding a worker's assignments to include additional but similar tasks

job redesign a type of job enrichment in which work is restructured to cultivate the worker–job match combining tasks, forming work groups, or establishing closer customer relationships. Employees often are more motivated when jobs are combined because the increased variety of tasks presents a more rewarding challenge. Depending on the form it takes, job redesign can give employees a stronger sense of belonging to a team, a clearer image of how their work contributes to the organization as a whole, and a more personal investment in the satisfaction of clients. Furthermore, a job redesign that carefully matches worker to job can prevent stress-related injuries. Employees may play an active role in redesigning their jobs to their liking. If employees recognize opportunities to rework their job in such a way as to improve efficiency or productivity, they may want to approach a superior with the idea.

Job enrichment works best with employees who want more challenging work. Employees must desire personal growth and have the skills and knowledge to perform more complex tasks. Lack of self-confidence, fear of failure, and distrust of management's intentions are likely to lead to ineffective performance on enriched jobs. Some workers prefer routine jobs because they find them satisfying. Job enrichment would not be appealing for these individuals. Companies that use job enrichment as an alternative to specialization also face extra expenses, such as the cost of retraining.

ISTOCK.COM/PHYNART STUDIO

Job enlargement versus job enrichment. It's no secret. Doing the same task over and over at your job is boring. Being able to do a variety of tasks (job enlargement) helps. Having more responsibility over how you do your job (job enrichment) is even better.

10-5c Behavior Modification

Behavior modification is a systematic program of reinforcement to encourage desirable behavior. Behavior modification involves both rewards to encourage desirable actions and punishments to discourage undesirable actions. Rewards, such as compliments and expressions of appreciation, tend to be much more effective behavior modifiers than punishments, such as reprimands and scorn.

When applied to management, behavior modification strives to encourage desirable organizational behavior. This technique begins with identifying and measuring a *target behavior*—the behavior that is to be changed (e.g., low production levels or a high rate of absenteeism). Next, managers provide positive reinforcement in the form of a reward when employees exhibit the *desired behavior* (e.g., increased production or less absenteeism). The reward might be praise or a more tangible form of recognition, such as a gift, meal, or trip. For example, Apple has a Corporate Gifts and Rewards Program that gives companies the ability to reward their staff or very loyal customers with Apple Watches, iPhones, iPads, Mac computers, or Apple gift cards. Finally, the levels of the target behavior are measured again to determine whether the desired changes have been achieved. If the target behavior has not changed significantly in the desired direction, the reward system must be changed to one that is likely to be more effective. The key is to devise effective rewards that will not only modify employees' behavior in desired ways, but also motivate them. To this end, experts suggest that management should reward quality, loyalty, and productivity.

10-5d Flexible Scheduling Options

behavior modification a systematic program of reinforcement to encourage desirable behavior

The needs and lifestyles of today's workforce are changing. Dual-income families make up a much larger share of the workforce than ever before, and women are one of its fastest-growing sectors. In addition to child-rearing duties, a growing number

Entrepreneurial Success

How to Recognize Employees for a Job Well Done

Rewarding employees with praise or recognition for a job well done is a form of positive reinforcement. For Generation Z and Millennial employees in particular, positive reinforcement is a major contributor to satisfaction in the workplace. According to a study by daVinci Payments, a payroll solutions firm, many young employees feel dissatisfied with their work but say that more recognition would increase a sense of loyalty to their employer. One way for small businesses to build a culture of recognition is to implement a recognition program.

Recognition should feel meaningful and authentic. To achieve this, employee recognition programs should be tied to specific business objectives, and recognition should be delivered promptly. This can come in the form of gift cards, customized gifts, a free meal, volunteer opportunities, awards, social media accolades, and more. While small businesses may have limited resources to offer financial incentives, an everyday thank-you, such as a handwritten note, can be just as meaningful. To have the greatest impact, employers should link employee achievements with the company's overall success, sharing how employee efforts are helping the organization reach its objectives. Once a program is in place, employers should continually reassess recognition efforts to ensure employee needs are being met.

Implementing recognition programs can help employees better understand how their contributions are connected to the bigger picture. Employee appreciation builds trust, boosts productivity, encourages high performance, increases engagement, decreases turnover, and improves brand reputation.

Sources: Based on information in Bennett Conlin, "19 Creative Ways to Show Employee Appreciation," *Business News Daily*, February 18, 2021, www.businessnewsdaily.com/8152-employee-appreciation-tips.html; Claire Hastwell, "Creating a Culture of Recognition," *Great Place to Work*, November 24, 2020, www.greatplacetowork.com/resources/blog/creating-a-culture-of-recognition; Stephen Miller, "Generation Z and Millennials Seek Recognition at Work," *Society for Human Resource Management*, September 12, 2019, www.shrm.org/resourcesandtools/hr-topics/benefits/pages/generation-z-and-millennials-seek-recognition-at-work.aspx.

of employees are responsible for the care of older relatives. The U.S. Bureau of Labor Statistics estimates that 40 million Americans are assisting at least one parent 65 years or older with daily living activities,[11] and most of these caretakers are also employees who may have to come in late, leave early, or make other adjustments to care for their family member. Moreover, younger workers are increasingly seeking out employers that offer more flexible work schedules. Recognizing that these changes increase the demand for flexibility during the normal work day, a growing number of employers are offering flexible work schedules to help employees manage their time better and increase employee motivation and job satisfaction.

Flextime is a system in which employees set their own work hours within certain limits determined by employers. Typically, the firm establishes two bands of time: the *core time*, when all employees must be at work, and the *flexible time*, when employees may choose whether to be at work. The only condition is that every employee must work a total of eight hours each day. For example, the hours between 9 and 11 a.m. and 1 and 3 p.m. might be core times, and the hours between 6 and 9 a.m., 11 a.m. and 1 p.m., and 3 and 6 p.m. might be flexible times. This would give employees the option of coming in early and getting off early, coming in later and leaving later, or taking a long lunch break. But flextime also ensures that everyone is present at certain times, when conferences with supervisors and department meetings can be scheduled.

Another flexible scheduling option is the **compressed workweek**, which allows employees to work the same number of hours in a shorter time period. Compressed workweeks are typically defined as 40 hours of work in four days instead of five, although a few companies specify that it is 80 hours of work over a nine-day period. In both situations, workers gain three-day weekends or longer, though they must work longer hours each day to get it. Compressed workweeks are becoming more

flextime a system in which employees set their own work hours within employer-determined limits

compressed workweek allows employees to work a 40-hour work week in four days instead of five popular, particularly outside the United States. When Microsoft Japan experimented with compressed workweeks, it found that not only did productivity rise by 40 percent, but the unit's electricity costs declined by 23 percent. Other companies with compressed workweeks have reported improved productivity, creativity, and employee satisfaction.[12] Of course, compressed workweeks may not be appropriate for all organizations.

Research has found that employees with more flexible schedules experience less stress and burnout and greater job satisfaction; their employers say well-managed flexible scheduling programs can boost employee retention, productivity, diversity, and employee engagement while reducing their need for office space and overall carbon footprint.[13] However, two common problems associated with using flexible schedules are (1) supervisors sometimes find their jobs complicated by having employees who come and go at different times and (2) employees with more conventional work schedules sometimes resent co-workers who have flextime.

While most people still work standard 40-hour weeks, flexible schedules are becoming much more common and easier to manage as improvements in technology allow people to stay connected, no matter where they are or what time it is. The medical and health professions, education and training departments, administrative jobs, and accounting divisions are all likely to offer flexible schedule options. For example, the accounting financial services firm Deloitte has offered flexible scheduling options for decades. The global company has found that this flexibility helps satisfy employees because they have better work–life balance. It also helps Deloitte get closer to its environmental sustainability goals and achieve its gender parity goals by attracting more working parents. Its flexible work policies have helped land Deloitte on *Working Mother* magazine's "100 Best Companies" list for more than 20 years.[14] Flex policies like this help reduce employee burnout and keep turnover low in what can be a stressful industry.

part-time work permanent employment in which individuals work less than a standard work week

job sharing an arrangement whereby two people share one full-time position

10-5e Part-Time Work and Job Sharing

Part-time work is permanent employment in which individuals work less than a standard work week. The specific number of hours worked varies, but part-time jobs are structured so that all responsibilities can be completed in the number of hours an employee works. Part-time work is of special interest to students and parents who need more time with their children. While some firms, such as Starbucks, REI, Costco, and Trader Joe's, are famous for offering part-time workers benefits, most do not offer this perk. In fact, more companies are switching to part-time workers in order to cut back on the rising cost of offering benefits, especially the health-insurance benefits now required of all companies with more than 50 full-time employees.

VICTOR MASCHEK/SHUTTERSTOCK.COM

Part-time pay, full-time benefits. Many employees want to work part-time but can't afford not to have benefits such as health insurance. Companies known for hiring part-time employees with full benefits include Starbucks, REI, Lands' End, UPS, and Barnes & Noble.

Job sharing (sometimes referred to as *work sharing*) is an arrangement whereby two people share one full-time position. One job sharer may work from 8 a.m. to noon, and the other from 1 to 5 p.m., or they may alternate workdays. Job sharing is different than part-time work because two people share one single position, which is generally more skilled than a part-time position would be. Job sharing can be difficult to orchestrate at the beginning, but may contribute to greater job satisfaction and ease in creating work–life balance. Job sharing can actually lead people to be more productive, as they know that their time at work is limited and that someone else is directly depending on the quality of their work. Job sharing combines the security of a full-time position with the flexibility of a part-time one, which may be especially valuable for working parents. For firms, job sharing provides a unique opportunity to attract highly skilled employees who are not available on a full-time basis. In addition, companies can save on benefits expenses and avoid the disruptions of employee turnover. For employees, opting for the flexibility of job sharing may mean giving up some of the benefits, such as health insurance, received for full-time work. Job sharing is difficult if tasks are not easily divisible or if two people do not work or communicate well with one another.

10-5f **Telecommuting**

A rapidly growing number of companies allow **telecommuting**, working remotely all the time or for a portion of the work week. Technology such as email, cloud computing, smart phones, laptops, tablets, video conferencing, and overnight couriers all make skipping the commute to work at home, a coffee shop, or coworking office easier and more convenient than ever before. Working at home means that individuals can set their own hours and have more time with their families as long as they produce the desired results. Telecommuting has boomed 173 percent since 2005, and now comprises 3.6 percent of the U.S. workforce, excluding the self-employed.[15] Of course, during the COVID-19 pandemic, telecommuting and working at home became even more prevalent, and some organizations have said their employees can continue to telecommute as long as they desire. Telecommuting can be especially beneficial for employees with disabilities, working parents, and employees taking care of family members who are older or disabled, though in fact, telecommuters include all demographic groups.

telecommuting working remotely all the time or for a portion of the work week

Technology and Innovation

The Work-From-Home Revolution Goes High-Tech

During the COVID-19 pandemic, organizations rapidly shifted to telecommuting. Organizations quickly had to find ways to communicate and collaborate. This led to the accelerated adoption of cloud-based videoconferencing platforms such as Zoom and collaboration software such as Microsoft Teams. Zoom's daily downloads increased more than 30 times year-over-year with total users reaching more than 200 million. Even as the pandemic subsided, many organizations made the switch to telecommuting permanent.

Historically, businesses hesitated to allow employees to work from home due to productivity concerns, but the forced adoption of a remote workforce proved that working from home could be efficient and effective. As the pandemic continued, some organizations introduced permanent work-from-home policies, from partial telecommuting to fully remote workforces. For example, Facebook, Twitter, Coinbase, Zillow, Shopify, and Microsoft all gave employees the option to work from home ongoing at least part-time.

Existing platforms such as communications software Slack and project management tool Asana welcomed the work-from-home revolution. The movement also gave rise to new platforms such as Microsoft Viva. Viva analyzes employee activity to improve wellbeing and provides a hub for company resources. Managers receive de-identified insights to protect employee privacy. Viva joins an emerging category of employee experience technology that aims to improve work quality and employee satisfaction. Microsoft's investment in this area suggests the digital workforce is here to stay.

Sources: Based on information in Dain Evans, "How Zoom Became So Popular During Social Distancing," *CNBC*, April 4, 2020, www.cnbc.com/2020/04/03/how-zoom-rose-to-the-top-during-the-coronavirus-pandemic.html; Gillian Friedman and Kellen Browning, "July Is the New January: More Companies Delay Return to the Office," *The New York Times*, October 13, 2020, www.nytimes.com/2020/10/13/technology/offices-reopening-delay-coronavirus.html; Todd Bishop, "Microsoft Unveils 'Viva' on Teams in Bid To Shake up $300B Employee Experience Technology Market," *GeekWire*, February 4, 2021, www.geekwire.com/2021/microsoft-unveils-viva-teams-bid-shake-300b-employee-experience-technology-market.

ISTOCK.COM/FATCAMERA

Office space—at home. Some companies are finding it cost-effective to allow employees to work at home. Working at home means that parents can spend more time with their children. Telecommuting arrangements such as this can be a win–win situation for both employees and their firms.

A growing body of research indicates that telecommuters are actually more effective than their in-office counterparts. Numerous research studies have found that telecommuting employees generally perform better and faster than their peers who work in the office. Additionally, they are more likely to continue working even when they are sick. Finally, remote workers generally report higher levels of happiness and personal satisfaction with their work.[16]

In addition to increased productivity, companies that allow occasional telecommuting have lower real estate and travel expenses, improved morale, and the flexibility to access larger labor pools. Telecommuting also reduces fossil fuel emissions from putting fewer cars on the road, and employees who do not have to commute report lower levels of stress. When Chinese travel website Ctrip allowed half of its employees to telecommute, the company saved $1,900 per employee in furniture and space costs over nine months. Moreover, the telecommuting employees were so efficient that they effectively netted the company an extra day of work per week. The telecommuters used fewer sick days, quit at a much lower rate, and reported much higher job satisfaction.[17]

Among the disadvantages of telecommuting are feelings of isolation, putting in long hours, and being distracted by family or household responsibilities. The stigma also remains, in spite of evidence to the contrary, that telecommuters are less productive than office-based staff. In addition, some supervisors have difficulty monitoring the productivity of remote workers.

10-5g **Employee Empowerment**

Many companies are increasing employee motivation and satisfaction through the use of empowerment. **Empowerment** means making employees more involved in their jobs and in the operations of the organization by increasing their participation in decision making. With empowerment, control no longer flows exclusively from the top level of the organization downward. Empowered employees have a voice in what they do and how and when they do it. In some organizations, employees' input is restricted to individual choices, such as when to take breaks. In other companies, their responsibilities may encompass more far-reaching issues. Successful companies treat their employees like assets, empowering them to fully utilize their talents. Technology clearly plays a role in empowering employees. Allowing employees access to information, such as reports, performance data, and communications, can empower them and make them feel more satisfied with their jobs.

For empowerment to work effectively, management must be involved. Managers should set expectations, communicate standards, institute periodic evaluations, and guarantee follow-up. If effectively implemented, empowerment can lead to increased job satisfaction, improved job performance, higher self-esteem, and increased organizational commitment. Obstacles to empowerment include resistance on the part of management, distrust of management on the part of workers, inadequate training of employees, and poor communication between levels of the organization.

empowerment making employees more involved in their jobs by increasing their participation in decision making

Ethics and Social Responsibility

HP Empowers Employees for Good

Empowering employees to make decisions, solve problems, and innovate can contribute to motivation and satisfaction. Some employers are taking this concept and applying it to sustainability and social responsibility. Hewlett-Packard (HP) believes that empowering individuals is key to the success of its sustainable impact strategy.

The human, economic, and environmental impacts of sustainability issues can feel too immense to tackle for any one individual, but HP hopes to change that by offering employees the agency to set their own sustainability and social responsibility goals. Employees can support closed-loop recycling, help customers transition to a circular economy, or join the HP Racial Equality and Social Justice Task Force to identify opportunities to improve racial equality within HP, just to name a few examples. Employees are given training and support to sync initiatives with their individual roles and job responsibilities, giving them a greater sense of control and purpose in their work. This, in turn, supports HP's corporate vision and strategy and creates lasting, transformative change at scale.

HP creates more than just PCs, printers, and mobile solutions; it also creates change. The company is fueling purpose, passion, and ingenuity for employees across every job function, and, as HP sees it, it is effectively empowering a 55,000-person worldwide sustainable impact team. By turning employee interests into action, the technology company demonstrates that sustainability and social responsibility are core to HP's culture.

Sources: Based on information in Ellen Jackowski, "Empowering a Cultural Shift to Accelerate a More Sustainable and Just Future," *CSR Wire*, January 27, 2021, www.csrwire.com/press_releases/717876-empowering-cultural-shift-accelerate-more-sustainable-and-just-future; HP, "HP Racial Equality and Social Justice," www8.hp.com/us/en/hp-information/about-hp/diversity/racial-equality.html.

10-5h Employee Ownership

Some organizations have discovered that an effective technique for motivating employees is **employee ownership**—that is, employees own the company they work for by virtue of being stockholders. Employee-owned businesses directly reward employees for success. When the company enjoys increased sales or lower costs, employees benefit directly. The National Center for Employee Ownership, an organization that studies employee-owned American businesses, reports that employee stock ownership plans (ESOPs) provide considerable employee incentive and increase employee involvement and commitment. In the United States today, an estimated 14 million employees participate in 6,416 ESOPs.[18] Employees in an ESOP may own all or part of a company's stock. In the United States, employee-owned companies include Publix Super Markets, Harpoon Brewing, Bob's Red Mill Natural Foods, and Davey Tree. ESOPs have also become more popular in Europe.

As a means to motivate executives and managers to feel invested in the company as they work long days, some firms provide stock options as part of the employee compensation package. An option is simply the right to buy shares of the firm within a prescribed time at a set price. If the firm does well and its stock price rises past the set price (presumably because of all the work being done by the employee), the employee can exercise the option and sell the stock to cash in on the company's success. However, not all companies choose to engage in ESOPs because they can be complex and expensive for the firm. This is particularly true of smaller organizations that may not have the means to manage such a program.

✓ Concept Check

- What are the five steps of most MBO programs?
- How can companies use job enrichment as a method for motivating employees?
- What is behavior modification and how is it used in organizations?
- What benefits does a company receive when using flextime, job sharing, and telecommuting?
- How do employee ownership and employee empowerment help in increasing employee motivation and satisfaction?

employee ownership a situation in which employees own the company they work for by virtue of being stockholders

Summary

10-1 Explain motivation and its importance.

Motivation is the individual internal process that energizes, directs, and sustains behavior. Motivation is affected by employee morale—that is, the employee's feelings about the job, superiors, and the firm itself. Motivation, morale, and job satisfaction are closely related.

10-2 Describe some major historical perspectives on motivation.

One of the first approaches to employee motivation was scientific management, the application of scientific principles to the management of work and workers. In attempting to determine the effects of the work environment on productivity, the Hawthorne Studies found that human factors affect productivity more than physical aspects of the workplace do. Maslow's hierarchy of needs suggests that people are motivated by, in ascending order of complexity, physiological, safety, social, esteem, and self-actualization needs. As needs at one level are satisfied, people try to satisfy needs at the next level. Frederick Herzberg found that job satisfaction and dissatisfaction are influenced by two distinct sets of factors. Motivation factors, including recognition and responsibility, affect an employee's degree of satisfaction, but their absence does not necessarily cause dissatisfaction. Hygiene factors, including pay and working conditions, affect an employee's degree of dissatisfaction but do not affect satisfaction.

Theory X is a concept of motivation that assumes that employees dislike work and will function effectively only in a highly controlled environment. Thus, to achieve an organization's goals, managers must coerce, control, and threaten employees. This theory generally is consistent with Taylor's ideas of scientific management. Theory Y is more in keeping with the results of the Hawthorne Studies and the human relations movement. It suggests that employees can be motivated to behave as responsible members of the organization. Theory Z emphasizes long-term employment, collective decision making, and individual responsibility for the outcomes of decisions, informal control, and a holistic concern for employees.

Reinforcement theory is based on the idea that people will repeat behavior that is rewarded and will avoid behavior that is punished.

10-3 Explore three contemporary views of motivation: equity theory, expectancy theory, and goal-setting theory.

Equity theory maintains that people are motivated to obtain and preserve equitable treatment for themselves. Expectancy theory suggests that our motivation depends on how much we want something and how likely we think we are to get it. Goal-setting theory suggests that employees are motivated to achieve a goal that they and their managers establish together.

10-4 Discuss the effects of organizational culture on employee performance.

Organizational culture, which refers to the inner rituals, traditions, processes, and values of a firm, plays a significant role in employee motivation. When managers develop and nurture a culture that addresses the reasons why people work, employees are more likely to be motivated to work toward the organization's goals. There are four distinct types of organizational cultures: clan, adhocracy, hierarchy, and market culture types.

10-5 Explain several techniques for increasing employee motivation.

Management by objectives (MBO) is a motivation technique in which managers and employees collaborate in setting goals. Job enrichment seeks to motivate employees by varying their tasks and giving them more responsibility for and control over their jobs. Job enlargement, expanding a worker's assignments to include additional tasks, is one aspect of job enrichment. Job redesign is a type of job enrichment in which work is restructured to improve the worker–job match.

Behavior modification uses reinforcement to encourage desirable behavior. Rewards for productivity, quality, and loyalty change employees' behavior in desirable ways and increase motivation.

Allowing employees to work flexible hours is another way to build motivation and job satisfaction. Flextime is a system of work scheduling that allows workers to set their own schedules, as long as they fall within the limits established by employers. A compressed workweek allows employees to work the same number of hours in a shorter time period. Part-time work is permanent employment in which individuals work less than a standard work week. Job sharing is an arrangement whereby two people share one full-time position. Telecommuting allows employees to work remotely for all or part of the work week. All of these work arrangements give employees more time outside the workplace to deal with family responsibilities or to enjoy free time.

Employee empowerment and employee ownership are also techniques that boost employee motivation. Empowerment increases employees' involvement in their jobs by increasing their decision-making authority. When employees participate in ownership programs, such as employee stock ownership plans (ESOPs), they have more incentive to make the company succeed and therefore work more effectively.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

motivation (275)
morale (276)
scientific management (276)
human relations (278)
Maslow's hierarchy of needs (278)
motivation-hygiene theory (279)
motivation factors (280)
hygiene factors (280)
Theory X (281)
Theory Y (281)
Theory Z (282)
reinforcement theory (282)
equity theory (283)
expectancy theory (284)
goal-setting theory (285)
organizational culture (285)
management by objectives (MBO) (288)
job enrichment (289)
job enlargement (289)
job redesign (289)
behavior modification (290)
flextime (291)
compressed workweek (291)
part-time work (292)
job sharing (292)
telecommuting (293)
empowerment (294)
employee ownership (295)

Discussion Questions

1. How did the results of the Hawthorne Studies influence researchers' thinking about employee motivation?
2. What are the five levels of needs in Maslow's hierarchy? How are a person's needs related to motivation?
3. What are the two dimensions in Herzberg's theory? What kinds of elements affect each dimension?
4. According to equity theory, how do employees determine whether they are being treated equitably?
5. According to expectancy theory, what two variables determine motivation?
6. How can managers nurture organizational cultures that motivate employees?
7. Which type of organizational culture do you think would best motivate employees? Least motivate?
8. What are the objectives of the MBO? What do you think might be its disadvantage?
9. How do flexible scheduling strategies and telecommuting increase motivation?
10. How can employee empowerment and ownership increase motivation?
11. What combination of motivational techniques do you think would result in the best overall motivation and reward system?

Case 10

Google's Employee Perks Satisfy

Google is continually recognized for its employee-centric culture and is considered one of the best companies to work for. This is due in large part to Google's wide array of employee benefits. Bicycles and scooters to get across campus, complimentary meals, healthcare, on-site physicians, gaming rooms, and nap pods are just a few of the things that individuals enjoy at Google.

Google's workplace culture is built on data. Every decision Google makes hinges on qualitative and quantitative data. It's no surprise, then, that the company's human resources (HR) department, called People Operations, uses data analytics to glean insights about employee behavior. As an example, the company measures total waiting time for employees at lunch to improve the flow of the cafeterias. Using internal data offers a way for the tech giant to increase happiness and satisfaction. For example, when the company uncovered high turnover rates among employees who were pregnant, Google introduced an enhanced paid parental leave policy.

Google's culture fosters fun and creativity. Ping pong, billiards, and foosball tables as well as arcade-style video games are found throughout Google's buildings. Free meals add to the appeal of working at Google's offices. Instead of confining employees to cubicles, they are encouraged to make use of a variety of community areas including breakout zones, coffee bars, lounges, and cafeterias. Google's headquarters, called the Googleplex, was designed by South African architect Clive Wilkinson who kept teamwork and creativity top of mind when creating the facility. The Googleplex's features were intended to boost productivity and improve employee satisfaction. Workspaces are designed to accommodate three to four people, which is said to be effective for sharing ideas without distracting the rest of the office. Employees are encouraged to share ideas and engage in discussion with co-workers because it can lead to unexpected, innovative results.

Google takes a decentralized approach to empowering its employees. It's said that employees are often allowed to use 20 percent of their time for independent side projects to promote and inspire creativity. This side project mindset gave birth to many of Google's most successful products such as Gmail, AdSense, and Google News. One of Google's pillars for innovation is to strive for continual innovation rather than instant perfection. For example, the initial version of AdWords released in 1999 was a flop. But, after many iterations and experiments, Google reached the Google Ads model that exists today. Extending its 20-percent-time concept even further, Google introduced the Google.org Fellowship that allows its employees to work full-time for nonprofit partners for up to six months. Collectively, Google aims for 50,000 hours of pro bono work annually through the program. The program allows Google to have a lasting impact in the areas of education, criminal justice, and economic opportunity while allowing its employees to grow and gain outside experience and inspiration.

Looking to the future, one challenge Google faces is maintaining its fun, creative culture as the workforce becomes increasingly remote. This presented itself during the COVID-19 pandemic when Google ordered employees to stay home for more than a year, affecting nearly all of the company's full-time and contract employees. Google employees were told they could not expense food or gym costs while working from home in an updated policy. Employees went as far as to say their productivity declined due to the lack of free coffee and food. Google will likely have more and more remote employees in the long run and will need to identify ways to engage remote team members.

As a global leader in the tech space, Google has high demands and standards for its employees. By building a culture of happiness and supporting employees' creative endeavors, Google can not only attract and retain top talent but also improve productivity and fuel innovation. This innovative work environment is one of the reasons Google is so successful.[19]

Questions

1. How does Google promote creativity and innovation?
2. How is data analytics used to inform Google's benefits?
3. What perks could Google offer to engage remote employees?

Building Skills for Career Success

1. Social Media Exercise

Infosys is a successful software company with nearly 250,000 employees. Social media are integral to its strategy and communications approach. The company uses social media to engage younger employees in these processes and to empower them. To do so, the company created STRAP Surround as a social platform to engage employees and allow executives to teach. It contains blogs, discussion forums, an in-house version of YouTube for video sharing, and a range of physical activities and games. The system has provided a mountain of data on its workforce for executives to process.

Here is one example. Employees participated in a series of live events related to a strategy execution topic. These events resulted in tens of thousands of ideas shared via social media. Through these events, management discovered some new things about the effectiveness of different communications media. For example, social media was most effective for structured questions, such as those asking about technologies for future growth, digital consumer behavior, and healthcare. Moderators made sure to thank participants, and the information gathered was passed along to managers. Some employees who provided particularly useful answers were chosen to become team members.[20]

1. Do you think social media are an effective way to engage employees in large organizations? Why or why not?
2. Do you think social media would work well in smaller companies? Why or why not?
3. Do you think that using social media changes the organizational culture and the way in which teams communicate for the better or worse? Explain your answer.

2. Building Team Skills

Empowerment makes workers feel more involved in their jobs and the operations of the organization by involving them in decision making. However, empowerment is a tool that is used inconsistently in different workplaces. If you worked in a position that did not empower you, would you want it? How do you envision empowerment looking in the workplace?

Assignment

Form small groups of three or four. Each member of the group should think about the last time you had a complaint that you brought to a company's attention. Perhaps you purchased an item that quickly malfunctioned, you wanted to exchange a pair of pants for a larger size, or you were not happy with the service you received at an auto body shop.

1. Who helped you address the problem? Was the salesperson empowered to give you a refund or an exchange? Or did the employee have to call in a manager?
2. Every group member should share their experiences with one another.
3. Discuss the following among your group:
    a. From the perspective of upper management, what are the pros and cons of empowering workers to take care of problems?
    b. What about from the perspective of the employees?
    c. How did your experiences as customers change, depending on how empowered the workers were? Did you prefer dealing with the employee or the manager?

3. Researching Different Careers

Because a manager's job varies from department to department within firms, as well as among firms, it is virtually impossible to write a generic description of a manager's job. If you are contemplating becoming a manager, you may find it helpful to shadow several managers to learn firsthand what they do.

Assignment

1. Make an appointment with managers in three firms, preferably firms of different sizes. When you make the appointments, request a tour of the facilities.
2. Ask the managers the following questions:
    a. What do you do in your job?
    b. What do you like most and least about your job? Why?
    c. What skills do you need in your job?
    d. How much education does your job require?
    e. What advice do you have for someone thinking about pursuing a career in management?
3. Summarize your findings in a two-page report. Include answers to these questions:
    a. Is management a realistic field of study for you? Why?
    b. What might be a better career choice? Why?

At Graeter's, Tenure Is "a Proud Number"

Although you might think working for an ice-cream company would be motivating under almost any circumstances, Graeter's doesn't take its employees' commitment for granted. Including full-time and part-time seasonal workers, the company employs about 800 people in three production facilities and 55 ice-cream shops. Teenagers who take a summer job at a Graeter's shop often return to help out during the winter holidays and then come back to work the following summer, and the summer after that. Production employees tend to remain with the company for long periods, as well, and Graeter's is relying on their experience and expertise as it expands its national distribution and opens new stores far from the Cincinnati base.

Professional Procedures with Personal Touches

Over the last few years, Graeter's has benefitted from tightening up some of its long-standing human resources management (HRM) procedures, including those for hiring and evaluating employees. David Blink, the company's controller, explains: "We hire based on potential . . . . We are looking for people who are conscientious about their work, who do a good job, who show up every day. We are a fun place to work . . . . We have turnover based on seasonal work only because we hire a lot of college kids [and] high school kids" to work during the summer months. Managers begin recruiting during the spring so that each store is fully staffed in advance of the peak ice-cream buying season. The company also accepts job applications through its website.

When filling job openings at its three factories, Graeter's looks for people with baking industry skills. On the job, employees and managers alike wear name badges that show the number of years they have worked for the firm, "and that is a proud number," says Blink. Graeter's adds a personal touch by celebrating employees' birthdays and milestones such as 25 years of service with the firm.

According to a consultant who works with top management, goals and measurement systems weren't strongly emphasized in the company's early days. "If [employees] came in and they made ice cream, if they made enough for the week, for the day, that was enough," he says. These days, however, Graeter's sets specific production and store goals so that all employees know what is expected of them. It also has measurement systems in place to track progress toward those goals. "We have defined the behaviors that are acceptable and not acceptable within the company," the consultant continues. "We communicate that. We teach and educate people." At the retail level, Graeter's training focuses on how employees can make the in-store experience engaging, fun, and memorable for customers.

In the factory, higher production goals have given newly empowered employees achievements to boast about on the slogan T-shirts they wear. The workforce is eager to submit suggestions for improvement, and morale is high. The company also offers advancement opportunities for employees who are ready to take on more responsibility. Graeter's low rate of turnover indicates that employees feel involved with the firm and the work they do. In fact, some employees spend their entire working careers with Graeter's and eventually retire from the firm.

Benefits That Pay

The benefits package for managers and full-time employees is competitive. Graeter's offers profit sharing, and it has made a profit year after year. It also has a 401(k) retirement plan that matches employees' contributions, plus a rolling allowance for paid time-off that is separate from paid vacations and holidays, and is based on the employee's tenure with the firm. Other benefits include medical, life, and disability insurance. Store employees wear uniforms (paid for by the company) and receive a 25 percent discount when they buy Graeter's products. All managers and employees receive the training they need to be effective in their positions and to develop their professional skills.

"You Can't Do It Alone"

The management team has grown as the company moves forward with its aggressive nationwide expansion plans. CEO Richard Graeter, a great-grandson of the company's founders, believes in recruiting outstanding people, compensating them well, and giving them the autonomy they need to get things done. "In the last few months," he notes, "I have hired a vice president of sales and marketing . . . [and] we hired a vice president of finance, basically a CFO [chief financial officer] because we are big enough to support that . . . Identifying the gaps in your executive team and your talent pool, and going out and finding people to fill those gaps, is probably one of my most critical functions in addition to looking out to define the strategic direction of the company. I've got some wonderful people on the team now, and they are really helping us make the jump from a small business to a medium-sized business . . . People at that level, you've got to pay them well. It's worth it, though . . . They can command the kind of salary they do because they bring the talent you need to navigate the waters."

"You can't do it alone," Richard concludes. "That is the other thing that I think my cousins and I all have come to realize; we can't do it alone. Our fathers and aunt and the folks that came before them . . . they did it all, from figuring out where to build the next store to hanging up the laundry at the end of the day." Now, to achieve the fast-growing company's ambitious goals, he's found that "you need to rely on talent that is beyond just you."[21]

Questions

1. Imagine that you're a human resources manager for Graeter's. If you were writing the job specification for an entry-level, part-time employee who will serve customers in one of the scoop shops, what qualifications would you include, and why?
2. Food production facilities like the three Graeter's factories must comply with strict regulations to ensure purity and safety. What kinds of teams might Graeter's use in these facilities, and for what specific purposes?
3. Graeter's is currently a nonunion company. How might the experience of working there change if a union were to be introduced?

Building a Business Plan

Part 4

In this section of your business plan, you will expand on the type and quantity of employees that will be required to operate the business. Your human resources requirements are determined by the type of business and by the size and scale of your operation. From the preceding section, you should have a good idea of how many people you will need. Part 4 of your textbook, "Human Resources," especially Chapters 9 and 10, should help you in answering some of the questions in this part of the business plan.

The Human Resources Component

To ensure successful performance by employees, you must inform workers of their specific job requirements. Employees must know what is expected of the job, and they are entitled to expect regular feedback on their work. It is vital to have a formal job description and job specification for every position in your business. Also, you should establish procedures for evaluating performance.

The labor force component should include the answers to at least the following questions:

4.1. How many employees will you require, and what qualifications should they have—including skills, experience, and knowledge? How many jobs will be full-time? Part-time?
4.2. Will you have written job descriptions for each position?
4.3. Have you prepared a job application form? Do you know what can legally be included in it?
4.4. What criteria will you use in selecting employees?
4.5. Have you made plans for the orientation process?
4.6. Who will do the training?
4.7. What can you afford to pay in wages and salaries? Is this in line with the going rate in your region and industry?
4.8. Who will evaluate your employees?
4.9. Will you delegate any authority to employees?
4.10. Have you developed a set of disciplinary rules?
4.11. Do you plan to interview employees when they resign?

Review of Business Plan Activities

Remember that your employees are the company's most valuable and important resource. Therefore, make sure that you expend a great deal of effort to acquire and make full use of this resource. Check and resolve any issues in this component of your business plan before beginning Part 5. Again, make sure that your answers to the questions in each part are consistent with the entire business plan. Finally, write a brief statement that summarizes all the information for this part of the business plan.

PART 5

Marketing

EONEREN/ISTOCK/GETTY IMAGES

Chapter 11
Building Customer Relationships Through Effective Marketing

Chapter 12
Creating and Pricing Products That Satisfy Customers

Chapter 13
Distributing and Promoting Products

IPOPBA/ISTOCK/GETTY IMAGES

The business activities that make up a firm's marketing efforts are those more directly concerned with satisfying customers' needs. In this part, we explore these activities in some detail. Initially, we discuss markets, marketing mixes, marketing environment forces, marketing plans, and buying behavior. Then, we discuss the four elements that together make up a marketing mix: product, price, distribution, and promotion.

Chapter

11

ISTOCK.COM/HISPANOLISTIC

Building Customer Relationships Through Effective Marketing

Learning Objectives

Once you complete this chapter, you will be able to:

11-1 Describe the meaning of *marketing* and the importance of managing customer relationships.

11-2 Explain how marketing adds value by creating several forms of utility.

11-3 Discuss the development of the marketing concept and how it is implemented.

11-4 Define what markets are and classify them.

11-5 Describe the two major components of a marketing strategy—target market and marketing mix.

11-6 Explain how the marketing environment affects strategic market planning.

11-7 Examine the major components of a marketing plan.

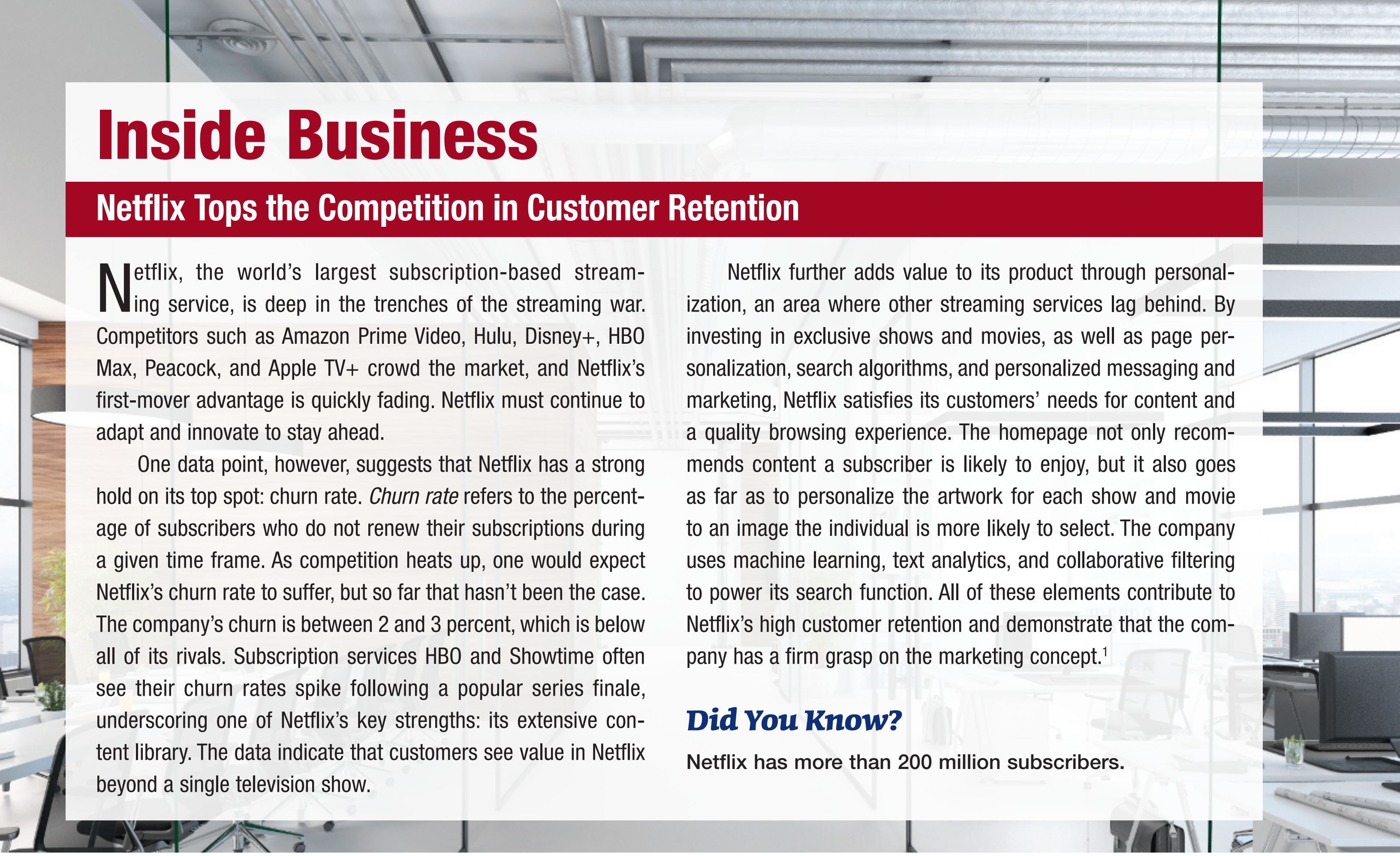
11-8 Describe how market measurement and sales forecasting are used.

11-9 Explain how marketers collect and analyze information useful for marketing decision making.

11-10 Identify the major steps in the consumer buying decision process and the sets of factors that may influence this process.

Why Should You Care?

Marketers are concerned about building long-term customer relationships. To develop competitive product offerings, business people must identify acceptable target customer groups and understand their behaviors.



Inside Business

Netflix Tops the Competition in Customer Retention

Netflix, the world's largest subscription-based streaming service, is deep in the trenches of the streaming war. Competitors such as Amazon Prime Video, Hulu, Disney+, HBO Max, Peacock, and Apple TV+ crowd the market, and Netflix's first-mover advantage is quickly fading. Netflix must continue to adapt and innovate to stay ahead.

One data point, however, suggests that Netflix has a strong hold on its top spot: churn rate. *Churn rate* refers to the percentage of subscribers who do not renew their subscriptions during a given time frame. As competition heats up, one would expect Netflix's churn rate to suffer, but so far that hasn't been the case. The company's churn is between 2 and 3 percent, which is below all of its rivals. Subscription services HBO and Showtime often see their churn rates spike following a popular series finale, underscoring one of Netflix's key strengths: its extensive content library. The data indicate that customers see value in Netflix beyond a single television show.

Netflix further adds value to its product through personalization, an area where other streaming services lag behind. By investing in exclusive shows and movies, as well as page personalization, search algorithms, and personalized messaging and marketing, Netflix satisfies its customers' needs for content and a quality browsing experience. The homepage not only recommends content a subscriber is likely to enjoy, but it also goes as far as to personalize the artwork for each show and movie to an image the individual is more likely to select. The company uses machine learning, text analytics, and collaborative filtering to power its search function. All of these elements contribute to Netflix's high customer retention and demonstrate that the company has a firm grasp on the marketing concept.[1]

Did You Know?

Netflix has more than 200 million subscribers.

Like Netflix, organizations use marketing activities to inform customers about their range of products and how these products can satisfy customer demand and create value. Understanding customers' needs and wants are crucial to providing the products that satisfy them. Although marketing encompasses a diverse set of decisions and activities, it always begins and ends with the customer. The American Marketing Association defines **marketing** as the "activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large."[2] **Value** is a customer's estimation of the worth of a product based on a comparison of its costs and benefits, including quality, relative to other products. For some people, value means the lowest price, but for others it might mean products that cost more but last a long time. The marketing process involves eight major functions and numerous related activities, all of which are essential to the marketing process (refer to Table 11-1).

In this chapter, we examine how marketing activities add value to products. We begin by exploring how organizations seek to maintain positive relationships with customers through marketing activities and develop products that create utility. We trace the evolution of the marketing concept and describe how organizations practice it. Next, we shift our focus to classifying markets and developing marketing strategy by targeting an appropriate marketing mix at a target market. We also examine the uncontrollable factors in the marketing environment and the major components of a marketing plan. Then we consider tools for strategic market planning, including market measurement, sales forecasts, marketing analytics, and marketing research. Finally, we look at the forces that influence consumer and organizational buying behavior.

marketing the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large

value a customer's estimation of the worth of a product based on a comparison of its costs and benefits, including quality, relative to other products

Table 11-1 Eight Major Marketing Functions

Exchange functions: All companies—manufacturers, wholesalers, and retailers—buy and sell to market their merchandise.

1. **Buying** includes obtaining raw materials to make products, knowing how much merchandise to keep on hand, and selecting suppliers.
2. **Selling** creates possession utility by transferring the title of a product from seller to customer.

Physical distribution functions: These functions involve the flow of goods from producers to customers.

3. **Transporting** involves selecting a mode of transport that provides an acceptable delivery schedule at an acceptable price.
4. **Storing** goods is often necessary to sell them at the optimal selling time.

Facilitating functions: These functions help the other functions to take place.

5. **Financing** helps at all stages of marketing. To buy raw materials, manufacturers often borrow from banks or receive credit from suppliers. Wholesalers may be financed by manufacturers, and retailers may receive financing from the wholesaler or manufacturer. Finally, retailers often provide financing to customers.
6. **Standardizing** sets uniform specifications for products or services. Grading classifies products by size and quality, usually through a sorting process. Together, standardizing and grading facilitate production, transportation, storage, and selling.
7. **Risk taking**—even though competent management and insurance can minimize risks—is a constant reality of marketing because of such losses as bad-debt expense, obsolescence of products, theft by employees, and product-liability lawsuits.
8. **Gathering** market information is necessary for making all marketing decisions.

11-1 Managing Customer Relationships

Learning Objective

11-1 Describe the meaning of *marketing* and the importance of managing customer relationships.

Without relationships with customers, businesses would not be successful. Therefore, maintaining positive relationships with customers is an important goal for marketers. The term **relationship marketing** refers to marketing decisions and activities focused on achieving long-term, satisfying relationships with customers. Relationship marketing deepens and reinforces the buyer's trust in the company, which, as the customer's loyalty grows, increases a company's understanding of the customer's needs and desires. Successful marketers respond to customers' needs and strive to increase value to buyers continually over time. Eventually, this interaction becomes a solid relationship that fosters cooperation and mutual trust. The internet has expanded and improved relationship marketing options for many firms by making targeted communication faster, cheaper, and easier. Digital technologies allow firms to connect to consumers and interact with them in real time. This not only improves the speed at which firms can innovate, but also makes consumers feel more satisfied because they feel the firm is listening to them.

To build long-term customer relationships, marketers rely on marketing research and information technology. **Customer relationship management (CRM)** focuses on using information about customers to create marketing strategies that develop and sustain desirable customer relationships. By increasing customer value over time, organizations try to retain and increase long-term profitability through customer loyalty. Because CRM is such an important part of creating and building customer loyalty, many companies have developed high-tech tools aimed at helping them to identify their more profitable customers and to manage relations with them over the long term. Starbucks, for example, rewards regular customers through an app that records their purchase history and offers them free food or drink on their birthday or after accruing points.

relationship marketing establishing long-term, mutually satisfying buyer–seller relationships

customer relationship management (CRM) using information about customers to create marketing strategies that develop and sustain desirable customer relationships

Satisfaction
Service
Support
Loyalty
CUSTOMER RELATIONSHIP
Reliability
Quality
Marketing
Research

STOATPHOTO/SHUTTERSTOCK.COM

Developing long-term customer relationships. Many companies spend a considerable amount of money on marketing programs to develop and maintain long-term relationships with their customers—especially the valuable ones. Often it's more profitable to retain these customers by offering them big rewards than to attract new customers who may never develop the same loyalty.

The data accumulated from the app, along with store sales data and information about weather, holidays, and special events helps Starbucks understand customers' ordering habits so that it can personalize their experience and make astute recommendations according to time of day and weather—even if they normally frequent a different store. With nearly 20 million users, the Starbucks app helps the company build long-term relationships.[3] The accessibility of technology has contributed to a more even playing field for firms of all sizes.

Managing customer relationships requires identifying patterns of buying behavior and using this information to focus on the most promising and profitable customers. Companies must be sensitive to customers' requirements and desires and establish communication to build customers' trust and loyalty. In some instances, it may be more profitable for a company to focus on satisfying a valuable existing customer than to attempt to attract a new one who may never develop the same level of loyalty. This involves determining how much customers will spend over their lifetime. The **customer lifetime value (CLV)** is a measure

Sustaining the Planet

Customer Feedback Pushes Native to Go Plastic-Free

Native, a personal care company, understands the importance of developing long-term, satisfying relationships with its customers. The direct-to-consumer company, best known for its cult-favorite aluminum-free deodorant, enjoys a dedicated and loyal fan base. When its customers asked Native to reconsider its plastic packaging, the company listened and then introduced paper-based applicators for its all-natural products.

With an influx of customer requests for sustainable packaging, Native gathered and analyzed the feedback from a variety of sources including social media, customer service phone calls, and surveys. This marketing research revealed that customer communication related to environmentally conscious packaging had increased by more than 900 percent. After developing a prototype for the new packaging, Native sold 200 units, collected feedback, and analyzed the data. Based on input from the early adopters, Native made final tweaks before initiating a full rollout. The product innovation team is now considering ways to switch to 100 percent plastic-free packaging across its entire product mix.

Native has long relied on brand advocates to spread the word about the company's products. For example, Native leverages the 15,000 five-star reviews it has collected from customers to promote its deodorant, body wash, bar soap, and toothpaste. In the company's early years, Native knew it was onto something special when its repeat purchase rate reached 50 percent. By engaging with these loyal customers, Native can better understand their wants and needs, build a sense of trust, and deepen relationships.

Sources: Based on information in Kathryn Lundstrom, "Customer Feedback Inspired Native's New Plastic-Free Paper Packaging for Its Deodorant," *AdWeek*, July 20, 2020, www.adweek.com/brand-marketing/customer-feedback-inspired-natives-new-plastic-free-paper-packaging-for-its-deodorant; Eric Bandholz, "Native Deodorant Founder on Scaling to $100 Million in 2 Years," *Practical Ecommerce*, October 9, 2020, www.practicalecommerce.com/native-deodorant-founder-on-scaling-to-100-million-in-2-years; Madge Maril, "Native's Cult-Favorite Deodorant Now Comes In Plastic-Free Packaging," *The Zoe Report*, June 24, 2020, www.thezoereport.com/p/natives-plastic-free-deodorant-is-eco-friendly-swap-anyone-can-do-27617644.

of a customer's worth (sales minus costs) to a business during one's lifetime.[4] CLV also includes the intangible benefits of retaining lifetime-value customers, such as their ability to provide feedback to a company and refer new customers of similar value, and these are important considerations as well. The amount of money a company is willing to spend to retain such customers is also a factor. In general, when marketers focus on customers chosen for their lifetime value, they earn higher profits in future periods than when they focus on customers selected for other reasons.[5] It is a fairly straightforward task to calculate CLV. In fact, businesses can utilize reliable free online tools to calculate CLV. Because the loss of a potential lifetime customer can result in lower profits, managing customer relationships has become a major focus of marketers.

✓ Concept Check

- Why is managing customer relationships important?
- How can technology help to build long-term customer relationships?
- What are the benefits of retaining customers?

11-2 Utility: The Value Added by Marketing

Learning Objective

11-2 Explain how marketing adds value by creating several forms of utility.

Utility is the ability of a good or service to satisfy a human need. The latest Xbox, Nike Air Jordan athletic shoes, or Mercedes Benz luxury car all satisfy human needs. Thus, each possesses utility. There are four kinds of utility (refer to Figure 11-1).

Form utility is created by converting production inputs into finished products. Marketing efforts may influence form utility indirectly because the data gathered as part of marketing research are frequently used to determine the size, shape, and features of a product.

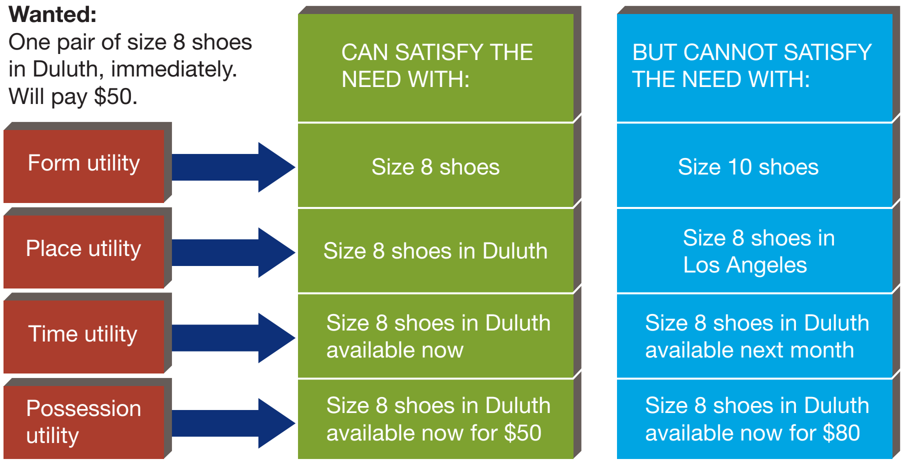
The three kinds of utility that are created directly by marketing are place, time, and possession utility. **Place utility** is created by making a product available at a location where customers wish to purchase it. A pair of shoes is given place utility when it is shipped from a factory to a department store or made available for sale at Zappos.com.

Time utility is created by making a product available when customers wish to purchase it. For example, Halloween costumes may be manufactured in April but not displayed until September, when consumers start buying them. By storing the costumes until there is a demand, the manufacturer or retailer provides time utility.

Possession utility is created by transferring title (or ownership) of a product to a buyer. For a product as simple as a pair of shoes, ownership usually is transferred by means of a sales slip or receipt. For such products as automobiles and homes, the transfer of title is a more complex process. Along with the title to products, the seller transfers the right to use that product.

Figure 11-1 Types of Utility

Form utility is created by the production process, but marketing creates place, time, and possession utility.



Wanted:
One pair of size 8 shoes
in Duluth, immediately.
Will pay $50.

	CAN SATISFY THE NEED WITH:	BUT CANNOT SATISFY THE NEED WITH:
Form utility	Size 8 shoes	Size 10 shoes
Place utility	Size 8 shoes in Duluth	Size 8 shoes in Los Angeles
Time utility	Size 8 shoes in Duluth available now	Size 8 shoes in Duluth available next month
Possession utility	Size 8 shoes in Duluth available now for $50	Size 8 shoes in Duluth available now for $80

customer lifetime value (CLV) a measure of a customer's worth (sales minus costs) to a business over one's lifetime

utility the ability of a good or service to satisfy a human need

form utility utility created by converting production inputs into finished products

place utility utility created by making a product available at a location where customers wish to purchase it

time utility utility created by making a product available when customers wish to purchase it

possession utility utility created by transferring title (or ownership) of a product to a buyer

Place, time, and possession utility have real value in terms of both money and convenience. This value is created and added to goods and services through a wide variety of marketing activities—from research suggesting desired features to advertising those features to product warranties ensuring that customers get what they pay for. Overall, these marketing activities account for about half of every dollar spent by consumers. When they are part of an integrated marketing program that delivers maximum utility to the customer, many would agree that they are worth the cost.

✓ Concept Check

- Explain the four kinds of utility.
- Provide an example of each.

11-3 The Marketing Concept

Learning Objective

11-3 Discuss the development of the marketing concept and how it is implemented.

The **marketing concept** is a business philosophy that a firm should provide goods and services that satisfy customers' needs through a coordinated set of activities that allow the firm to achieve its objectives. Initially, the firm communicates with potential customers to assess their product needs. Then, the firm develops a good or service to satisfy those needs. Finally, the firm continues to seek ways to provide customer satisfaction. This process is an application of the marketing concept or marketing orientation. Consider the century-old Nordstrom department store chain. Long renowned for its customer service, the company continues to innovate by developing and acquiring technology to improve its customer experience both in stores and online. It also satisfies regular customers with a rewards program and curbside pickup. Through partnerships, the company has brought in many new products to appeal to diverse consumers, especially Millennials. While other retailers are faltering and shuttering stores, Nordstrom is experimenting with new store concepts, like its inventory-free Nordstrom Local stores where customers can try on products, pick up Style Board orders that have been curated for them, and more. These efforts help Nordstrom learn what customers want now so that it can satisfy them and keep them coming back.[6] It is important to recognize that all functional areas—research and development, production, finance, human resources, and, of course, marketing—play a role in providing customer satisfaction.

marketing concept a business philosophy that a firm should provide goods and services that satisfy customers' needs through a coordinated set of activities that allow the firm to achieve its objectives.

BEST BUY
EXPRESS

LUKEANDKARLA.TRAVEL/SHUTTERSTOCK.COM

Putting products at the customer's fingertips. Firms try to provide customers with products when and where they need them.

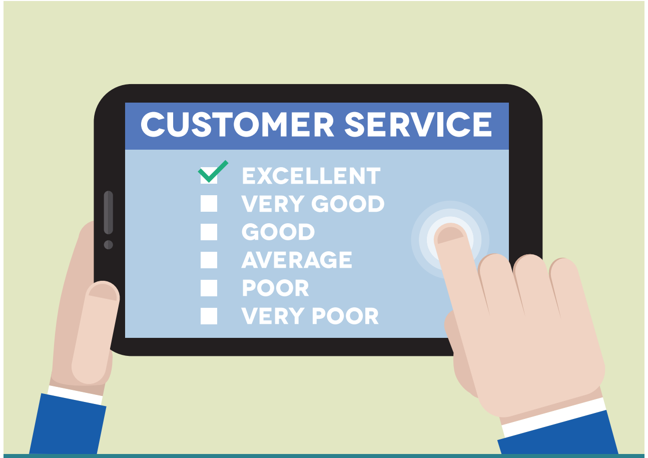
11-3a Evolution of the Marketing Concept

From the start of the Industrial Revolution until the early 20th century, business effort was directed mainly toward the production of goods. Consumer demand for manufactured products was so great that manufacturers could almost bank on selling everything they produced. Business had a strong *production orientation,* which placed an emphasis on increased output and production efficiency. Marketing activities were limited to taking orders and distributing finished goods.

In the 1920s, production caught up with and began to exceed demand. Producers had to direct their efforts toward selling goods rather than just producing them. This new *sales orientation* was characterized by increased advertising, enlarged sales forces, and, occasionally, high-pressure selling techniques. Manufacturers produced the goods they expected consumers to want, and marketing consisted primarily of promoting products through personal selling and advertising, taking orders, and delivering goods.

During the 1950s, however, businesspeople started to realize that even enormous advertising expenditures and proven sales techniques were not sufficient to gain a competitive edge. It was then that business managers recognized that they were not primarily producers or sellers, but were in the business of satisfying customers' needs. Marketers realized that the best approach was to adopt a *customer orientation*—in other words, the organization had to first determine what customers need and then develop goods and services to fill those particular needs (refer to Table 11-2).

The marketing concept is dynamic and has continued to evolve. In the late 1990s, marketers increasingly focused their efforts on building and maintaining long-term relationships with customers. This *relationship orientation* adopted customer relationship management tools and technology to try to retain and increase long-term profitability through customer loyalty. In today's digital world where consumers can find just about anything they want at the touch of a smartphone button, the marketing concept continues to evolve to include social media and mobile technology. As an example, Zappos, the online shoe store renowned for its customer service, uses social media to respond to consumer queries, resolve issues, elicit consumer feedback, and highlight customers, all of which help it refine its marketing strategies.[7] Marketers also must adopt multiple distribution channels to reach customers wherever and whenever they might choose to shop—in stores, online, and through smart device apps. Nonetheless, all marketers still must focus on providing products that satisfy customers' needs and wants as well as their own objectives.



PHOELIXDE/SHUTTERSTOCK.COM

Tell us what you *really* think. Customer satisfaction is a major element of the marketing concept. Many businesses attempt to measure customer satisfaction through surveys. Surveys can be conducted in a variety of ways: in person, by mail or phone, or online. Online surveys have made it very inexpensive for firms to gather customer feedback.

11-3b Implementing the Marketing Concept

To implement the marketing concept, a firm first must obtain information about its present and potential customers. The firm must determine not only what customers' needs are, but also how well these needs are satisfied by products currently in the market—both its own products and those of competitors. It must ascertain how its products might be improved and what opinions customers have about the firm and its marketing efforts.

The firm then must use this information to pinpoint the specific needs and potential customers toward which it will direct its marketing activities and resources.

Table 11-2 Evolution of Customer Orientation

Business managers recognized that they were not primarily producers or sellers, but were in the business of satisfying customers' wants.

Production Orientation	Sales Orientation	Customer Orientation	Relationship Orientation
Take orders	Increase advertising	Determine customer needs	Use all possible media to build relationships
Distribute goods	Enlarge sales force	Develop products to fill those needs	Increase value to customer over time
	Intensify sales techniques	Achieve the organization's goals	Gain customer loyalty and increase long-term profitability

Next, the firm must mobilize its marketing resources to (1) provide a product that will satisfy its customers, (2) price the product at a level that is acceptable to buyers and will yield a profit, (3) promote the product so that potential customers will be aware of its existence and its ability to satisfy their needs, and (4) ensure that the product is distributed so that it is available to customers where and when it is needed.

Finally, the firm must again obtain marketing information—this time regarding the effectiveness of its efforts. Can the product be improved? Is it being promoted effectively? Is it being distributed efficiently? Is the price too high or too low? The firm must be ready to modify any or all of its marketing activities based on information about its customers and competitors. Consider Zara, the fashion retailer owned by Spain-based Inditex, which employs a strategy of quickly designing, manufacturing, and stocking small quantities of fashion items—in as little as two weeks—and then nimbly updating inventories in response to customer reaction and requests. The firm's strategy and strong customer focus allow it to maintain fresh and exciting product assortments that keep customers happy.[8]

✓ Concept Check

- Identify the major components of the marketing concept.
- How did the customer orientation evolve?
- What steps are involved when implementing the marketing concept?

11-4 Markets and Their Classification

Learning Objective

11-4 Define what markets are and classify them.

A **market** is a group of individuals or organizations, or both, that need products in a given category and that have the ability, willingness, and authority to purchase them. Markets are broadly classified as consumer or business-to-business, and marketing efforts vary depending on the intended market. Marketers should understand the general characteristics of these two groups.

Consumer markets consist of purchasers and/or household members who intend to consume or benefit from the purchased products and who do not buy products to make profits. *Business-to-business (B2B) markets,* also called *industrial markets,* are grouped broadly into producer, reseller, governmental, and institutional categories. These markets purchase specific kinds of products for use in making other products for resale or for day-to-day operations. *Producer markets* consist of individuals and business organizations that buy certain products to use in the manufacture of other products. *Reseller markets* include intermediaries, such as wholesalers and retailers, that buy finished products and sell them for a profit. *Government markets* consist of federal, state, county, and local governments that buy goods and services to maintain internal operations and to provide citizens with such products as highways, education, water, energy, and national defense. Government purchases total billions of dollars each year. *Institutional markets* include churches, not-for-profit private schools and hospitals, civic clubs, fraternities and sororities, charitable organizations, and foundations. Their goals are different from the typical business goals of profit, market share, or return on investment.

✓ Concept Check

- What is a market?
- Identify and describe the major types of markets.

11-5 Developing Marketing Strategies

Learning Objective

11-5 Describe the two major components of a marketing strategy—target market and marketing mix.

A **marketing strategy** is a plan that will enable an organization to make the best use of its resources and advantages to meet its objectives. A marketing strategy consists of (1) the selection and analysis of a target market and (2) the creation and maintenance of an appropriate **marketing mix**, a combination of product, price, distribution, and promotion developed to satisfy a particular target market.

11-5a Target Market Selection and Evaluation

A **target market** is a group of individuals or organizations, or both, for which a firm develops and maintains a marketing mix suitable for the specific needs and preferences of that group. In selecting a target market, marketing managers

market a group of individuals or organizations, or both, that need products in a given category and that have the ability, willingness, and authority to purchase them examine potential markets for their possible effects on the firm's sales, costs, and profits. The managers attempt to determine whether the organization has the resources to produce a marketing mix that meets the needs of a particular target market and whether satisfying these needs is consistent with the firm's overall objectives. They also analyze the strengths and number of competitors already marketing to the target market. A target market can range in size from millions of people to only a few, depending on the product and the marketer's objectives. Consider Zipcar, a car-sharing company that targets people who live in cities and do not want to own a car, as well as those who cannot afford a car or only need one occasionally. Its target market treats cars as a sustainable option for getting around, not as a status symbol.[9] On the other hand, Rolls-Royce targets its automobiles toward a small, very exclusive market: wealthy people who want the ultimate in prestige in an automobile. Some companies target multiple markets with different products, prices, distribution systems, and promotions for each one. Some high-end clothing designers, for instance, target multiple markets when they introduce more affordable lines distributed at mass market retail outlets, such as Target and Walmart. This strategy allows designers to reach customers with varying needs and levels of disposable income. Target has partnered with such high-end designers as Victoria Beckham, Marimekko, and Lily Pulitzer to offer affordable versions of high-end products.[10] The strategy has introduced the normally elite brands to a much larger market, enhancing Target's stylish image.

CALVIN KLEIN
WOMEN
eau de parfum intense

GRZEGORZ CZAPSKI/SHUTTERSTOCK.COM

Reaching the right market segments. The market for fragrances is segmented based on gender. Some fragrances are aimed at men while others, such as the perfume in this photo, are aimed at women.

Undifferentiated Approach A company that designs a single marketing mix and directs it at the entire market for a particular product is using an **undifferentiated approach** (refer to Figure 11-2). This approach assumes that individual customers in the target market for a specific kind of product have similar needs and that the organization can satisfy most customers with a single marketing mix, which consists of one type of product with little or no variation, one price, one promotional program aimed at everyone, and one distribution system to reach all customers in the total market. Products that can be marketed successfully with the undifferentiated approach include staple food items, such as sugar and salt, and some produce. An undifferentiated approach is useful in only a limited number of situations because buyers have varying needs for most product categories, which requires the market segmentation approach.

Market Segmentation Approach Market segmentation is required because different consumers have different needs. A firm that markets 40-foot yachts would not direct its marketing effort toward every person in the total boat market, for instance, because not all boat buyers have the same needs. Marketing efforts directed at the wrong target market are wasted.

Instead, the firm should direct its attention toward a particular portion, or segment, of the total market for boats. A **market segment** is a group of individuals or organizations within a market that shares one or more common characteristics. The process of dividing a market into segments is called **market segmentation**. As shown in Figure 11-2, there are two market segmentation approaches: concentrated and differentiated. When an organization uses *concentrated* market segmentation, a single marketing mix is directed at a single market segment. Pair Eyewear, for example, targets its direct-to-consumer eyeglasses at children (and their parents) with fun colors and patterns, along with a child-friendly home tryout process.[11]

marketing strategy a plan that will enable an organization to make the best use of its resources and advantages to meet its objectives

marketing mix a combination of product, price, distribution, and promotion developed to satisfy a particular target market

target market a group of individuals or organizations, or both, for which a firm develops and maintains a marketing mix suitable for the specific needs and preferences of that group

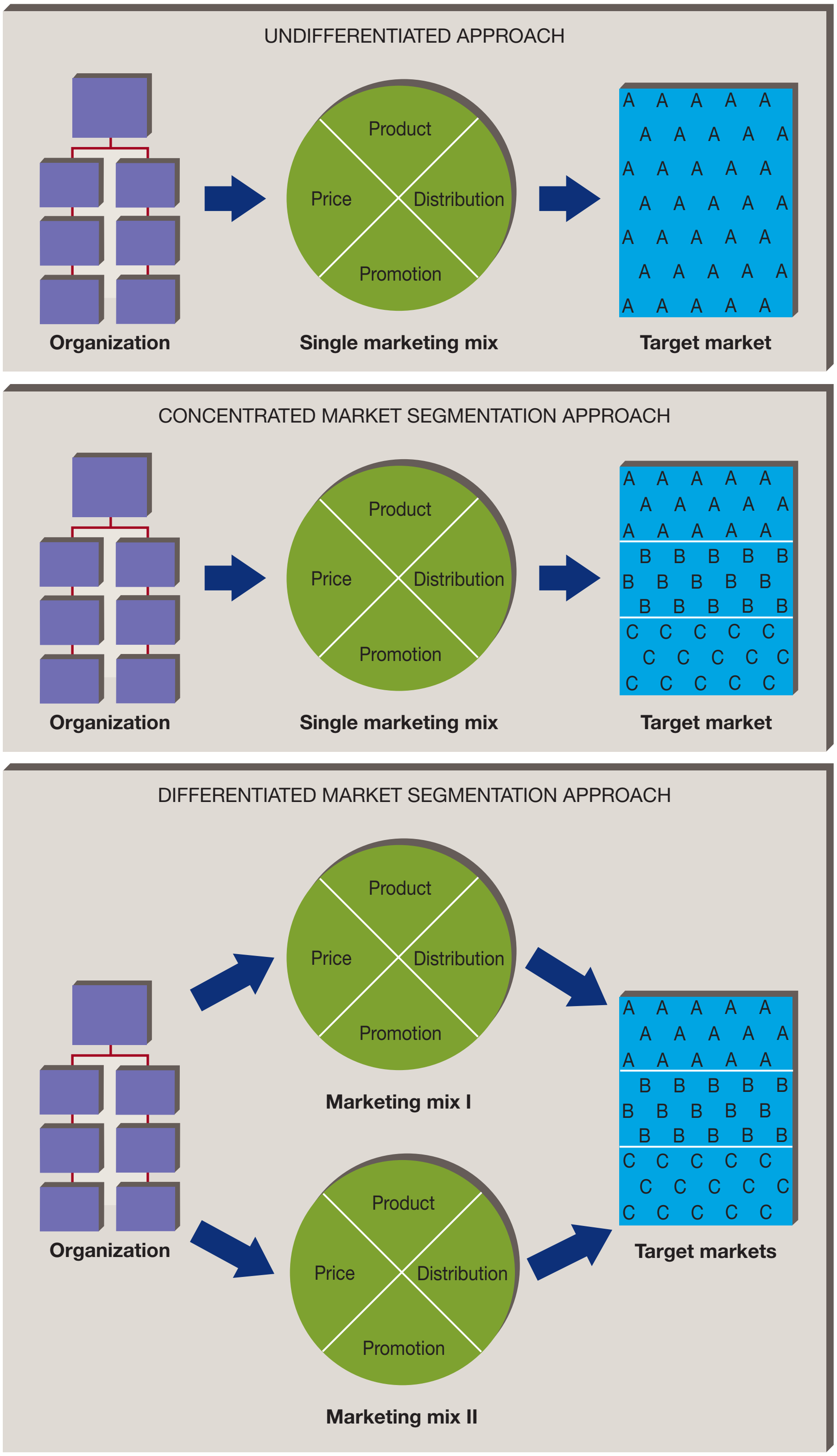
undifferentiated approach directing a single marketing mix at the entire market for a particular product

market segment a group of individuals or organizations within a market that shares one or more common characteristics

market segmentation the process of dividing a market into segments and directing a marketing mix at a particular segment or segments rather than at the total market

Figure 11-2 **General Approaches for Selecting Target Markets**

The undifferentiated approach assumes that individual customers have similar needs and that most customers can be satisfied with a single marketing mix. When customers' needs vary, the market segmentation approach—either concentrated or differentiated—should be used.


UNDIFFERENTIATED APPROACH
Product
Price
Distribution
Promotion
A A A A A
A A A A A
A A A A A
A A A A A
A A A A A
A A A A A
A A A A A
Organization
Single marketing mix
Target market
CONCENTRATED MARKET SEGMENTATION APPROACH
Product
Price
Distribution
Promotion
A A A A A
A A A A A
A A A A A
B B B B B
B B B B B
B B B B B
C C C C C
C C C C C
C C C C C
Organization
Single marketing mix
Target market
DIFFERENTIATED MARKET SEGMENTATION APPROACH
Product
Price
Distribution
Promotion
Marketing mix I
A A A A A
A A A A A
A A A A A
B B B B B
B B B B B
B B B B B
C C C C C
C C C C C
C C C C C
Organization
Target markets
Product
Price
Distribution
Promotion
Marketing mix II

Note: The letters in each target market represent potential customers. Customers that have the same letters have similar characteristics and similar product needs.

If *differentiated* market segmentation is used, multiple marketing mixes are focused on multiple market segments. Kellogg's employs a differentiated approach; for instance, it targets health-conscious consumers with Special K and Smart Start cereals, and parents of young children with Apple Jacks and Fruit Loops cereals and Pop-Tarts.

In our boat example, one common characteristic, or *basis*, for segmentation might be end use of a boat. The firm would be interested primarily in the market segment whose uses for a boat could lead to the purchase of a 40-foot yacht. Other bases for segmentation might be income or geographic location. Variables can affect the type of boat an individual might purchase. When choosing a basis for segmentation, it is important to select a characteristic that relates to differences in customers' needs for a product. The yacht producer, for example, would not use religion to segment the boat market because people's needs for boats do not vary based on religion.

Marketers use a wide variety of segmentation bases. Those most commonly applied to consumer markets are shown in Table 11-3. Each may be used as a single basis for market segmentation or in combination with other bases. For example, Honda and Toyota use gender and family life cycle as bases for marketing their respective minivans, the Odyssey and the Sienna, with features and advertising designed to appeal to parents.

Gillette
Gillette
SUFIAN HANIF/SHUTTERSTOCK.COM

Differentiated targeting strategy. Gillette employs a differentiated targeting strategy for its razors. The company uses multiple marketing mixes and aims them at multiple target markets. As shown here, Gillette aims its razor on the left at men and its razor on the right at women.

11-5b Creating a Marketing Mix

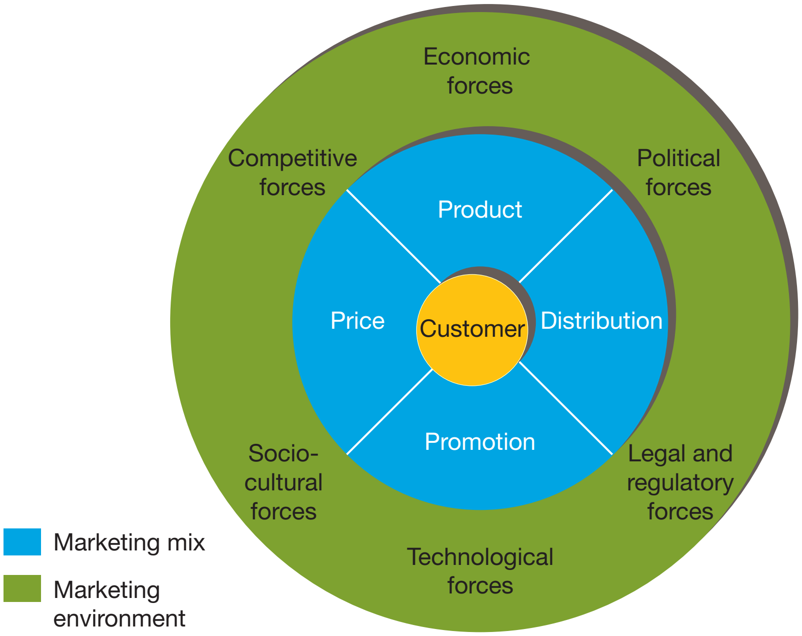
A business controls four important elements of marketing that it combines in a way that reaches the firm's target market. These are the *product* itself, the *price* of the product, the means chosen for its *distribution*, and the *promotion* of the product. When combined, these four elements form a marketing mix (refer to Figure 11-3). A firm can vary its marketing mix by changing any one or more of the ingredients. Thus, a firm may use one marketing mix to reach one target market and another

Table 11-3 **Common Bases of Market Segmentation**

Demographic	Psychographic	Geographic	Behavioristic
Age	Personality attributes	Region	Volume usage
Gender	Motives	Urban, suburban, rural	End use
Race	Lifestyles	Market density	Benefit expectations
Ethnicity		Climate	Brand loyalty
Income		Terrain	Price sensitivity
Education		City size	
Occupation		County size	
Family size		State size	
Family life cycle			
Religion			
Social class			

Figure 11-3 The Marketing Mix and the Marketing Environment

The marketing mix consists of elements that the firm controls—product, price, distribution, and promotion. The firm generally has no control over forces in the marketing environment.


Economic forces
Competitive forces
Political forces
Product
Price
Customer
Distribution
Promotion
Socio-cultural forces
Legal and regulatory forces
Technological forces
🟦 Marketing mix
🟩 Marketing environment

marketing mix to reach a different target market. For example, most automakers produce several different types and models of vehicles and aim them at different market segments based on the potential customers' age, income, family life-cycle stage, and other factors.

MONTICELLO/SHUTTERSTOCK.COM

Developing the right marketing mix. Firms have little control over the marketing environment. However, they *can* control the marketing mixes for their products—that is, the nature of the products themselves and how they are priced, distributed, and promoted. Marketers at PepsiCo have developed a specific marketing mix for regular Pepsi.

The most visible ingredient of the marketing mix is obviously the *product*. Product decisions typically relate to the product's design, functions, features, brand name, packaging, and warranties. When McDonald's decides on new menu items, brand names, package designs, sizes of orders, flavors of sauces, and recipes, these choices are all part of the product ingredient.

The *pricing* ingredient is concerned with both base prices and discounts. Consider the Samsung Galaxy Fold Z2 smartphone, which is priced at $2,000.[12] Pricing decisions are intended to achieve particular goals, such as to maximize profit or to make room for new models. The rebates offered by automobile manufacturers are a pricing strategy developed to boost low auto sales. Product and pricing are discussed in more detail in Chapter 12.

The *distribution* ingredient involves not only transportation and storage, but also intermediaries. How many levels of intermediaries are appropriate in the distribution of a particular product and should it be distributed as widely as possible or restricted to specialized outlets? Companies may have to alter the distribution ingredient over time. For example, as customers' consumption habits shift, retailers are adapting their distribution to include online and mobile sales. Retailers are increasingly developing their own apps to have greater control over their customer experience and to allow customers to order products whenever and wherever they might think about it. Sephora customers, for example, can use its app to shop for products and see their past purchases so they can reorder just the right shade. The app also lets shoppers "try on" various facial products so they can find the ideal products.[13]

Technology
Concept
Management
Flyer
Marketing
Digital
Business
Planning
Branding
Strategy
Communication

ISTOCK.COM/MARTIN KEILER

The *promotion* ingredient focuses on providing information to target markets. The major forms of promotion are advertising, personal selling, sales promotion, and public relations. Careful planning and implementation of promotional tools is crucial to ensure their effectiveness. Distribution and promotion are discussed in more detail in Chapter 13.

These ingredients of the marketing mix are controllable elements. A firm can vary each of them to suit its organizational and marketing goals and target market needs. For instance, it can add new features to a product or reduce its price to reach a particular segment or to boost its *market share*—the percentage of a market that actually buys a specific product from a particular company. Microsoft, for example, added Microsoft Editor, Teams for Consumers, and greater cloud storage to its Microsoft 365 subscription office software suite for personal use.[14] As we extend our discussion of marketing strategy, we will see that the marketing environment includes a number of *uncontrollable* elements as well.

✓ Concept Check

- What are the major components of a marketing strategy?
- Describe the major approaches used in target market selection.
- Identify the four elements of the marketing mix.

11-6 Marketing Strategy and the Marketing Environment

Learning Objective

11-6 Explain how the marketing environment affects strategic market planning.

The marketing mix consists of elements that a firm controls and uses to reach its target market. The firm also has control of organizational resources, such as finances and data, which can be utilized to accomplish marketing goals and refine the marketing mix. All of a firm's marketing activities can be affected by external forces, which are generally uncontrollable. As Figure 11-3 illustrates, the following forces make up the external *marketing environment:*

- *Economic forces*—the effects of economic conditions on customers' ability and willingness to buy;
- *Sociocultural forces*—influences in a society and its culture that result in changes in attitudes, beliefs, norms, customs, and lifestyles;
- *Political forces*—influences that arise through the actions of political figures;
- *Competitive forces*—the actions of competitors, who are in the process of implementing their own marketing plans;
- *Legal and regulatory forces*—laws that protect consumers and competition and government regulations that affect marketing; and
- *Technological forces*—technological changes that can create new marketing opportunities or cause products to become obsolete rapidly.

These forces influence decisions about marketing mix ingredients. Changes in the environment can affect existing marketing strategies. Consider the challenges faced by marketers during the COVID-19 pandemic and the resulting economic downturn. While many Americans slashed their spending after losing their jobs, many others began to work from home. Consumers bought more laptops, desk chairs, and baking supplies, but spent less on gasoline and cosmetics. All consumers spent more on cleaning supplies and pantry staples, but stopped going to movie theaters and gyms. Marketers had to shift gears to ensure they were offering the products consumers were willing to buy, pricing and promoting them appropriately, and distributing far more of them via online outlets, while navigating supply chain challenges and a shifting regulatory environment. In addition, changes in environmental forces may lead to dramatic shifts in customers' needs or wants. Consider the effect technological forces have had on printed newspapers. Years ago, very few people would have predicted that consumers would one day read the news on their phone, yet most people now do exactly that.

✓ Concept Check

- Describe the environmental forces that affect a firm's marketing decisions and activities.
- How are marketing decisions affected by environmental forces?

11-7 Developing a Marketing Plan

Learning Objective

11-7 Examine the major components of a marketing plan.

A **marketing plan** is a written document that specifies an organization's resources, objectives, marketing strategy, and implementation and control efforts to be used in marketing a specific product or product group. The marketing plan describes the firm's current position or situation, establishes marketing objectives for the product, and specifies how the organization will attempt to achieve these objectives. Marketing plans vary with respect to the time period involved. Short-range plans are for one year or less, medium-range plans cover from over one year to five years, and long-range plans cover periods of more than five years.

marketing plan a written document that specifies an organization's resources, objectives, strategy, and implementation and control efforts to be used in marketing a specific product or product group

Although time-consuming, developing a clear, well-written marketing plan is important. The plan helps establish a unified vision for an organization and is used for communication among the firm's employees. It covers responsibilities, tasks, and schedules for implementation, specifies how resources are to be allocated to achieve marketing objectives, and helps marketing managers monitor and evaluate

Table 11-4 Components of the Marketing Plan

Plan Component	Component Summary	Highlights
Executive summary	One- to two-page synopsis of the entire marketing plan	1. Stress key points 2. Include one to three key points that make the company unique
Environmental analysis	Information about the company's current situation with respect to the marketing environment	1. Assessment of marketing environment factors 2. Assessment of target market(s) 3. Assessment of current marketing objectives and performance
SWOT analysis	Assessment of the organization's strengths, weaknesses, opportunities, and threats	1. Strengths of the company 2. Weaknesses of the company 3. Opportunities in the environment and industry 4. Threats in the environment and industry
Marketing objectives	Specification of the firm's marketing objectives	1. Qualitative measures of what is to be accomplished 2. Quantitative measures of what is to be accomplished
Marketing strategies	Outline of how the firm will achieve its objectives	1. Target market(s) 2. Marketing mix
Marketing implementation	Outline of how the firm will implement its marketing strategies	1. Marketing organization 2. Activities and responsibilities 3. Implementation timetable
Performance evaluation	Explanation of how the firm will measure and evaluate the results of the implemented plan	1. Performance standards 2. Financial controls 3. Monitoring procedures (audits)

the performance of the marketing strategy. Because the forces of the marketing environment are subject to change, marketing plans have to be updated frequently. Consider Coca-Cola's Powerade sports drink brand, which has experienced lagging sales in recent years as exercise patterns shifted and consumers turned to other options like coconut water and enhanced waters after exercise. The company responded by adjusting its marketing mix to introduce new products, such as Power Water, a line of electrolyte-enhanced flavored water targeted at casual exercisers, and Powerade Ultra, targeted at more serious athletes with 50 percent more electrolytes and creatine, to compete.[15] Such changes in strategy will likely be reflected in the firm's marketing plan.

The major components of a marketing plan are shown in Table 11-4.

✓ Concept Check

- What are the major components of a marketing plan?
- Why is developing a well-written marketing plan important?

11-8 Market Measurement and Sales Forecasting

Learning Objective

11-8 Describe how market measurement and sales forecasting are used.

Measuring the sales potential of specific market segments can help an organization make important decisions. An accurate measure of a market segment can help a firm to determine the feasibility of entering new segments and how best to allocate marketing resources and activities among market segments in which it is already active. All such estimates should identify the relevant time frame. As with marketing plans, these plans may be short-range for periods of less than one year, medium-range for one to five years, or long-range for more than five years. The estimates should also define the geographic boundaries of the forecast, such as a city, county, state, or group of nations. Finally, analysts should indicate whether their estimates are for a specific product item, a product line, or an entire product category.

A **sales forecast** is an estimate of the amount of a product that an organization expects to sell during a certain period of time based on a specified level of marketing effort. Managers may rely on sales forecasts when they purchase raw materials, schedule production, secure financial resources, consider plant or equipment purchases, hire personnel, and plan inventory levels. Because the accuracy of a sales forecast is so important, organizations often use several forecasting methods, including executive judgments, surveys of buyers or sales personnel, time-series analyses, correlation analyses, and market tests. The specific methods used depend on the costs involved, type of product, characteristics of the market, time span of the forecast, purposes for which the forecast is used, stability of historical sales data, availability of the required information, and expertise and experience of forecasters. To assist with complicated predictions, many companies utilize sales forecasting software.

✓ Concept Check

- Why is sales forecasting important?
- What methods do businesses use to forecast sales?

11-9 Marketing Information

Learning Objective

11-9 Explain how marketers collect and analyze information useful for marketing decision making.

Developing effective marketing strategies requires understanding target markets. Marketers therefore require accurate and timely information about customers' needs and desires, new marketing opportunities, and changing customer attitudes and purchase patterns, as well as changes in the forces of the marketing environment. The availability and analysis of marketing information improve a firm's ability to make informed decisions and respond to a changing environment, which can lead to better performance. Thanks to the proliferation of information-gathering technology, marketers can obtain a wealth of data to support decision making.

11-9a Collecting and Analyzing Marketing Information

Marketers have greater access to reliable data and tools for analyzing them than ever before. **They often** use the term *big data* to refer to the massive amounts of data that come from a variety of sources. Data from *internal* sources include sales figures,

sales forecast an estimate of the amount of a product that an organization expects to sell during a certain period of time based on a specified level of marketing effort

Exploring Careers

Trend Alert: Market Research Analysts Are in High Demand

Data analysis and analytical reasoning are two of the most in-demand skills in the job market. Big data analytics—mining insights from large amounts of data to identify trends—has given rise to the market research analyst role in the United States. According to the U.S. Bureau of Labor Statistics, this role is projected to grow 18 percent within the next 10 years, significantly faster than the 4 percent average growth for all occupations.

Big data can come in the form of social media comments, online product reviews, transaction data, and much more. Marketers have a vast amount of data at their fingertips, but it's not always easy to know what to do with it or how to use it effectively. Analysts will be needed to identify customer needs and wants, establish key performance indicators (KPIs), monitor the impact of marketing strategies, and more. Problem-solving, identifying new opportunities, and monitoring and forecasting trends using statistical software and internal systems are just a few of the duties at the core of the market research analyst job.

Analytical skills, communication skills, critical thinking skills, and a detail-oriented mindset are important soft skills for data analysts. Analysts must be able to digest large amounts of data as well as have strong interpersonal skills to communicate their findings. A variety of employers such as marketing agencies, financial institutions, universities, and government agencies will seek out professionals matching this skill set as the market research analyst role becomes increasingly important.

Sources: Based on information in Mara Leighton, "5 Skills LinkedIn Say Will Help You Get Hired in 2020 - and Where to Learn Them," *World Economic Forum*, September 3, 2020, www.weforum.org/agenda/2020/09/linkedin-online-elearning-skills-jobs-hiring; U.S. Bureau of Labor Statistics, "Market Research Analysts," www.bls.gov/ooh/business-and-financial/market-research-analysts.htm.

product and marketing costs, inventory levels, and activities of the sales force. The savviest marketers also collect data from following every move consumers make on their websites and their social media interactions. Data from *external* sources relate to the organization's suppliers, intermediaries, and customers. It can also come from competitors' marketing activities and economic conditions.

Typically, these data are stored in one or more databases that allow marketers to access both internal and external sources. Many marketers also subscribe to commercial databases, such as LEXISNEXIS and Dun & Bradstreet's Data Cloud, to obtain information for marketing decisions. A great deal of information that used to be attainable only for a high price from companies specializing in producing commercial databases is now available via the internet.

Information provided by a single firm on household demographics, purchases, television-viewing and online behavior, and responses to promotions such as coupons and free samples is called *single-source data*. Consumers often use multiple devices to view shows and movies, including televisions, smartphones, and computers, making it difficult for companies to track media consumption habits and needs. To solve this problem, Nielsen has formed partnerships with Facebook, Twitter, and Instagram to compile accurate single-source data about what and how people are watching shows and when, as well as when they are talking about shows in social media. The partnerships represent a step forward in helping marketers track consumer media consumption over multiple devices.[16]

The internet, of course, is a powerful communication medium that links customers and organizations around the world and provides affordable data to help better understand customers. Companies like Lands' End and Paula's Choice that sell online accumulate data by tracking customers' purchases as well as the items they browse. By collecting and analyzing this data, the marketing information system helps the company track the buying habits of its most valued customers and informs decision making in response to these changes.

Businesses increasingly are using **marketing analytics**, the collection, organization, and interpretation of data about marketing performance, to mine useful insights from the huge amounts of data they collect. Marketing analytics begins with collecting and organizing the massive amounts of data obtained from customer contacts, retailer scanning, inventory management, and production. For instance, frequent-user programs like Marriott's Bonvoy not only collect data about customers' usage patterns by time of day, week, month, and year, but they can also ask loyal customers to participate in surveys about their needs and desires. Supermarkets and other retailers may offer store discount cards, which allow them to gain data on purchases through checkout scanners. These can be combined with other information a firm can acquire such as industry forecasts, business trends, and search data. The size and complexity of the diverse data requires sophisticated computer programs to store, organize, and analyze it. Many firms use customer relationship management (CRM) technologies and cloud computing to network technologies and organize the marketing data available to them.

Marketing analytics can allow marketers to look at patterns of purchase and consumption to discover trends that predict future buying behaviors. Not all of these patterns would be as visible through traditional marketing research methods. Identifying these trends and patterns can result in more precise adjustments to marketing strategies or entirely new ones. Consider the Coca-Cola Company, which crunches numbers not only from sales but also from social media, vending machines, and self-serve soft drink fountains that permit customers to mix their own drinks. Analysis of these data identified that the most popular combination mixed at fountains was Sprite with cherry shots, so the company introduced Cherry Sprite as a new flavor of soft drink. The company has also installed some vending machines with artificial intelligence that can adapt to their location and personalize customer

marketing analytics the collection, organization, and interpretation of data about marketing performance

Technology and Innovation

TikTok Uses AI and Big Data to Keep Users Coming Back for More

China-based TikTok, an app for sharing short-form videos, is one of the world's fastest-growing social networking platforms. With a reported 500 million active global users, TikTok knows a thing or two about keeping its users engaged. TikTok's parent company, ByteDance, is a multinational technology company that works with artificial intelligence (AI) algorithm development and big data analysis to understand and impact user behavior.

TikTok videos, which range from 5 to 60 seconds long, cater to a short attention span. The app defaults to the "For You" tab, a curated, seemingly never-ending feed of lip-syncing, storytelling, memes, makeup tutorials, cooking instructions, dancing, and more. Videos play automatically, quickly sucking users in. Users can easily swipe up to load new videos. The algorithm learns from user engagement—from watch time and likes to shares and comments—to personalize video recommendations in real time, getting better and better as time goes on. The average user opens the app eight times a day, consuming 46 minutes of content.

These personalization algorithms are at the heart of the app's technology. TikTok found that when app users are shown previews and given a choice of what to watch, such as on the YouTube app, they often disengage from the platform, overwhelmed by determining what to watch next. By delivering a hyper-personalized feed that immediately immerses users, TikTok answers the user's question of "What should I watch?" for them and better satisfies users with a frictionless experience.

Sources: "Explaining TikTok's Machine Learning Algorithm," *Jumpstart Mag*, June 22, 2020, www.jumpstartmag.com/explaining-tiktoks-algorithm; Katie Sehl, "20 Important TikTok Stats Marketers Need to Know in 2020," *Hootsuite*, May 7, 2020, https://blog.hootsuite.com/tiktok-stats; "How Cutting-Edge AI Is Making China's TikTok the Talk of Town," *Medium*, November 15, 2018, www.medium.com/beautytech-jp/how-cutting-edge-ai-is-making-chinas-tiktok-the-talk-of-town-4dd7b250a1a4.

selections as well as report sales data back to the company.[17] Marketing analytics provides new understanding of customer behavior that has the potential to help firms create competitive advantage.

11-9b **Marketing Research**

Although analyzing marketing information yields useful insights, it does not always provide specific information to solve a problem or refine a strategy, in which case research may be called for. **Marketing research** is the process of systematically gathering, recording, and analyzing data concerning a particular marketing problem. Marketing research is an important step of the marketing process because it involves collecting and analyzing data on what consumers want and need, their consumption habits, trends, and changes in the marketing environment. Information obtained from research increases marketers' ability to respond to those changes. For instance, many marketers would be interested in recent research that found that consumers are more likely to trust product recommendations from a family member, friend, or social media influencer than from brands on social media.[18] Such research can point marketers to new marketing channels for reaching particular target market segments.

Marketers collect *primary data* directly from consumers when they conduct mail, telephone, personal interview, online, focus group, or social networking surveys or conduct direct observation of consumer behavior. For example, focus groups are often used to test actual consumer reactions to advertisements, product modifications, and even movie endings. Marketers use *secondary data* from sources compiled inside or outside of the firm to help support marketing research initiatives. These sources often include commercial and government reports as well as internal databases. Marketing researchers are increasingly monitoring blogs and social networks to discover what consumers are saying about their products—both positive and negative. Many companies use social media outlets to solicit feedback from customers on their existing or upcoming products. While there is always a risk that customers will give a company or its products bad reviews online, most firms deem the risk worthwhile to conduct the low-cost research they need to be successful. If handled correctly, consumer complaints can be an important source of data on how to improve products and services. Indeed, the internet has made marketing research easier and cheaper than ever. Social media sites such as Facebook and Twitter can help small firms gauge potential market demand and try out product ideas for little or no cost. The internet also offers numerous databases and other sources of valuable information on competitors, target markets, and the marketing environment.

marketing research the process of systematically gathering, recording, and analyzing data concerning a particular marketing problem

ISTOCK.COM/KATARZYNABIALASIEWICZ

Focus groups. Many business organizations use focus groups as one method of doing marketing research. A variety of different types of information can be collected through focus groups.

Table 11-5 lists a variety of useful resources for secondary information, which is existing information that has been gathered by other organizations. As can be seen in Table 11-5, secondary information can come from a variety of sources, including governments, trade associations, general publications and news outlets, and corporate information.

Table 11-6 outlines a six-step procedure for conducting marketing research. It is particularly well suited to test new products, determine various characteristics of consumer markets, and evaluate promotional activities. Even when marketers outsource marketing research to external firms such as IQVIA, Nielsen, and IRI, these firms generally apply this process.

Table 11-5 Sources of Secondary Information

Government Sources	
U.S. Census	https://www.census.gov/
International Trade Administration—country market research	https://www.trade.gov/research-country
National Technical Information Services	https://www.ntis.gov/
Canadian trade	https://strategis.ic.gc.ca/
Trade Associations and Shows	
Center for Association Leadership	https://www.asaecenter.org/
Directory of Associations	https://directoryofassociations.com/
Trade Show News Network	https://www.tsnn.com/
U.S. Chamber of Commerce	https://www.uschamber.com/
Magazines, Newspapers, Video, and Audio News Programming	
Google Video Search	https://www.google.com/videohp?hl=en
Google News Directory	https://news.google.com/
Yahoo! Video Search	https://video.search.yahoo.com/
Corporate Information	
The Public Register Online—corporate annual reports	http://www.publicregister.com/
Bitpipe	https://www.bitpipe.com/
Business Wire—press releases	https://www.businesswire.com/
PR Newswire—press releases	https://www.prnewswire.com/

Source: Adapted and updated from "Data Collection: Low-Cost Secondary Research," KnowThis.com, https://www.knowthis.com/data-collection-low-cost-secondary-research/low-cost-secondary-intro/ (accessed March 25, 2021).

✓ Concept Check

- How can marketing analytics improve marketing decisions?
- What are the major reasons for conducting marketing research?
- Identify and describe the six steps of the marketing research process.

Table 11-6 The Six Steps of Marketing Research

1. Define the problem.	The problem is stated clearly and accurately, as it will determine the research issues and approaches, the right questions to ask, and the types of solutions that are acceptable. This is a crucial step that should not be rushed.
2. Make a preliminary investigation.	The preliminary investigation aims to develop a sharper definition of the problem and a set of tentative answers, which are developed by examining internal information and published data and by talking with persons who have experience with the problem. These answers will be tested by further research.
3. Plan the research.	At this stage, researchers know what facts are needed to resolve the identified problem and what facts are available. They make plans on how to gather needed but missing data.
4. Gather factual information.	Once a plan is in place, researchers can collect primary data from surveys and/or observation, and get secondary data from commercial or government data sources. The choice depends on the plan and the available sources of information.
5. Interpret the information.	Facts by themselves do not always provide a sound solution to a marketing problem. They must be interpreted and analyzed to determine the choices available to management.
6. Reach a conclusion.	Once the data have been evaluated, researchers seek to draw conclusions and make recommendations. These may be obvious or not, depending on intangible factors and whether data used were complete. When there are gaps in the data, it is important for researchers to state this.

Ethics and Social Responsibility

Marketers Must Embrace Data Ethics

Privacy and data collection have become increasingly important issues, yet less than half of major brands have data ethics policies in place. Research from the World Federation of Advertisers (WFA) revealed that data ethics is a priority for marketers, but major gaps still exist between what companies should be doing to protect data versus what they are currently doing. The WFA hopes its findings will encourage businesses to be more proactive in their data practices and establish their own ethics policies.

Many companies have been criticized for the way they collect, store, and use customer data. The possibility of racial bias in artificial intelligence (AI), for example, raises ethical concerns. Humans are susceptible to bias, which can lead to the unintentional creation of discriminatory algorithms. IBM shut down its facial recognition programs due to concerns the AI-enabled algorithms would be used for mass surveillance, racial profiling, and human rights violations.

Individuals entrust businesses with vast amounts of personal information, from credit card data and mailing addresses to Social Security numbers and shopping preferences. Organizations should take the utmost care to protect consumer data with proper data handling and security measures to fend off breaches. Breaches can quickly erode consumer trust. Ancestry.com, a family history search company, faced a leak that exposed sensitive data belonging to 60,000 customers. Unlike other countries, the United States lacks general consumer data privacy laws, leaving businesses to self-regulate. According to the WFA, respect, fairness, accountability, and transparency should be at the center of data ethics policies.

Sources: Based on information in Rebecca Stewart, "CMOs Accept Data Ethics Falls on Their Shoulders, but Brands' Policies Are Lacking," *The Drum*, June 1, 2020, www.thedrum.com/news/2020/06/01/cmos-accept-data-ethics-falls-their-shoulders-brands-policies-are-lacking; Eugene Bekker, "2020 Data Breaches | The Most Significant Breaches of the Year," *Identity Force*, January 3, 2020, www.identityforce.com/blog/2020-data-breaches; "IBM Abandons 'Biased' Facial Recognition," *BBC*, June 9, 2020, https://www.bbc.com/news/technology-52978191.

11-10 Types of Buying Behavior

Learning Objective

11-10 Identify the major steps in the consumer buying decision process and the sets of factors that may influence this process.

Buying behavior may be defined as the decisions and actions of people involved in buying and using products. **Consumer buying behavior** refers to the purchasing of products for personal or household use, not for business purposes. **Business buying behavior** is the purchasing of products by producers, resellers, governmental units, and institutions. Because a firm's success depends in large part on buyers' reactions to a marketing strategy, it is important to understand buying behavior. Marketing managers are better able to predict customer responses to marketing strategies and to develop a satisfying marketing mix if they are aware of the factors that affect buying behavior.

buying behavior the decisions and actions of people involved in buying and using products

consumer buying behavior the purchasing of products for personal or household use, not for business purposes

business buying behavior the purchasing of products by producers, resellers, governmental units, and institutions

11-10a Consumer Buying Behavior

Consumers' buying behaviors differ for different types of products. For frequently purchased low-cost items, a consumer uses *routine decision making* which involves very little search or decision-making effort. The buyer uses *limited decision making* for purchases made occasionally, or when they need more information about an unknown product in a well-known product category. When buying an unfamiliar or expensive item, or one that is seldom purchased, the consumer engages in *extended decision making*. Consumers have become empowered by information available on the internet that allows them to compare prices and features and read reviews about goods and services without stepping into a store. Increasingly, buyers feel sufficiently informed by their online research to proceed with buying decisions without the help of a salesperson. In this environment, marketing and customer service are increasingly important.

A person deciding on a purchase goes through some or all of the steps shown in Figure 11-4. First, the consumer recognizes that a problem exists that might be solved by a good or service. The "problem" might be something the person desires but does not possess, like the latest iPhone or Xbox. Second, the buyer looks for information, which may include brand names, product characteristics, warranties, and other features, as well as product reviews. Next, the buyer weighs the various alternatives, makes a choice, and acquires the item. In the after-purchase stage, the consumer evaluates the suitability of the product, which will affect future purchases. Consider the Geico advertisement, which highlights the fact that its product can solve the problem of paying too much for insurance. The ad further informs potential consumers of the benefits of Geico's customer service in addition to saving them money on insurance products. As Figure 11-4 depicts, the buying process is influenced by situational factors (physical surroundings, social surroundings, time, purchase reason, and buyer's mood and condition), psychological factors (perception, motivation, learning, attitudes, personality, and lifestyle), and social factors (family, roles, reference groups, digital influences, social class, culture, and subculture).

Consumer buying behavior is also affected by the ability to buy, called one's *buying power*, which is largely determined by income. As every taxpayer

SAVINGS
IS JUST THE START
GEICO.COM
1-800-947-AUTO
LOCAL AGENT
GEICO

It starts with getting a quote to see if you could save 15% or more on car insurance. From there, you'll discover the comfort of 24/7 service with a licensed agent, the fast, fair, professional claim handling and why, for over 75 years, GEICO has been the choice of millions of drivers for all their insurance needs.

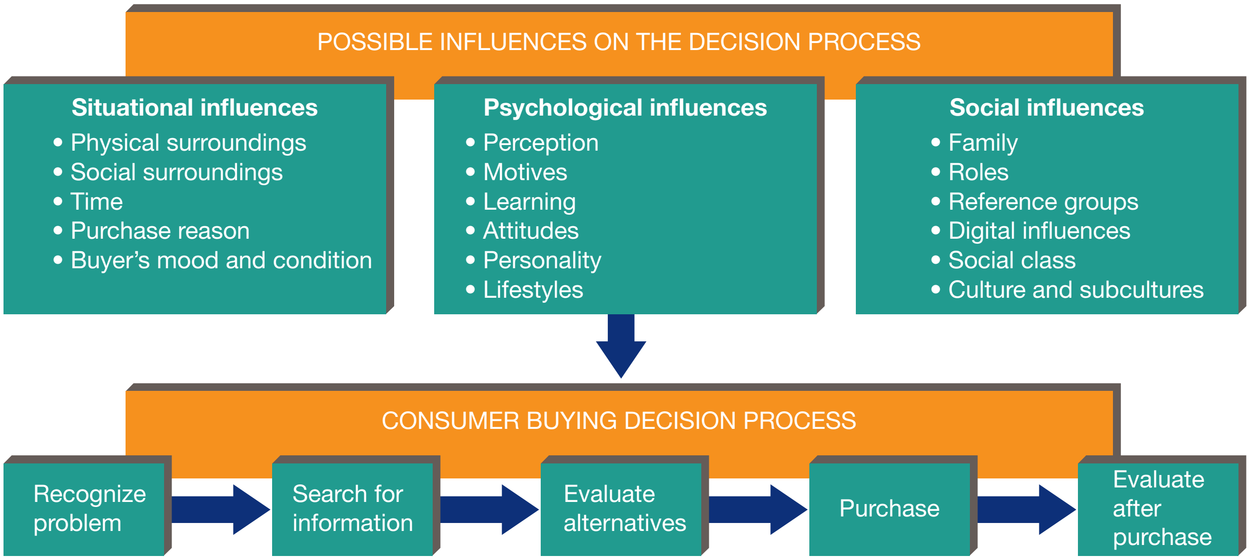
Some discounts, coverages, payment plans and features are not available in all states, in all GEICO companies, or in all situations. GEICO is a registered service mark of Government Employees Insurance Company, Washington, DC 20076; a Berkshire Hathaway Inc. subsidiary. © 2020 GEICO

SOURCE: GEICO

Problem recognition. This Geico advertisement attempts to stimulate problem recognition. What's the problem? How can I save money on my insurance?

Figure 11-4 Consumer Buying Decision Process and Possible Influences on the Process

A buyer goes through some or all of these steps when making a purchase.


POSSIBLE INFLUENCES ON THE DECISION PROCESS
Situational influences
• Physical surroundings
• Social surroundings
• Time
• Purchase reason
• Buyer's mood and condition
Psychological influences
• Perception
• Motives
• Learning
• Attitudes
• Personality
• Lifestyles
Social influences
• Family
• Roles
• Reference groups
• Digital influences
• Social class
• Culture and subcultures
CONSUMER BUYING DECISION PROCESS
Recognize problem
Search for information
Evaluate alternatives
Purchase
Evaluate after purchase

✓ Concept Check

- Why is it important to understand buying behavior?
- How does a customer's decision-making time vary with the type of product?
- What are the five stages of the consumer buying decision process?
- What are the possible influences on this process?
- What is the difference between disposable income and discretionary income?

knows, not all income is available for spending. For this reason, marketers consider income in three different ways. **Personal income** is the income an individual receives from all sources. **Disposable income** is personal income *less* all personal taxes. These taxes include income, estate, gift, and property taxes levied by local, state, and federal governments. **Discretionary income** is disposable income *less* savings and expenditures on food, clothing, and housing. Discretionary income is of particular interest to marketers because consumers have the most choice in spending it. Consumers use their discretionary income to purchase a wide variety of items ranging from automobiles and vacations to movies and pet food. In China, for example, a growing middle class with rising discretionary income is more interested than ever in Western brands. To capitalize on this demand, Walmart plans to open 14 more Sam's Club membership stores in China, bringing its total stores there to more than 40, all stocking popular Western brands alongside store branded Chinese products. It also plans to invest hundreds of millions of dollars in renovating existing stores and improving its supply chain there.[19]

personal income the income an individual receives from all sources

disposable income personal income *less* all personal taxes

discretionary income disposable income *less* savings and expenditures on food, clothing, and housing

11-10b Business Buying Behavior

The business buying decision process is similar to the consumer process, but business buyers are generally better informed than consumers and consider a product's quality, its price, and the service provided by suppliers. Business purchases can be large, and a committee or a group of people, rather than just one person, often decides on purchases. Committee members must consider the organization's objectives, purchasing policies, resources, and personnel. The process of business buying is different than consumer buying. It occurs through description, inspection, sampling, or negotiation. Because business transactions can be more complicated and orders tend to be larger, obtaining complete and correct information on buyers and sellers is important.

Summary

11-1 Describe the meaning of *marketing* and the importance of managing customer relationships.

Marketing is a set of processes for creating, communicating, and delivering value to customers and for managing customer relationships in ways that benefit the organization and its stakeholders. Value is a customer's estimation of the worth of a product based on a comparison of its costs and benefits, including quality, relative to other products. Maintaining positive relationships with customers is crucial. Relationship marketing is establishing long-term, mutually satisfying buyer–seller relationships. Customer relationship management (CRM) uses information about customers to create marketing strategies that develop and sustain desirable customer relationships. Managing customer relationships requires identifying patterns of buying behavior and focusing on the most profitable customers. Customer lifetime value (CLV) is a combination of purchase frequency, average value of purchases, and brand-switching patterns over the entire span of a customer's relationship with the company.

11-2 Explain how marketing adds value by creating several forms of utility.

Marketing adds value in the form of utility, or the ability of a product to satisfy a human need. It creates place utility by making products available where customers want them, time utility by making products available when customers want them, and possession utility by transferring the ownership of products to buyers.

11-3 Discuss the development of the marketing concept and how it is implemented.

From the Industrial Revolution until the early 20th century, businesspeople focused on the production of goods. From the 1920s to the 1950s, the emphasis moved to the selling of goods. During the 1950s, businesspeople began to recognize that they were in business not only to make and sell products, but also to satisfy customers' needs. They began to implement the marketing concept, a business philosophy that involves the entire organization in the dual processes of meeting the customers' needs and achieving the organization's goals. The marketing concept is dynamic and continues to evolve. Marketers today strive to build long-term relationships with customers wherever and whenever their needs arise.

Implementation of the marketing concept begins and ends with customers. A firm must first determine what customers' needs are and then pinpoint the specific needs and potential customers toward which it will direct its marketing activities and resources. Finally, the firm must evaluate the effectiveness of its efforts in meeting these needs.

11-4 Define what markets are and classify them.

A market is a group of individuals or organizations, or both, that need products in a given category and that have the ability, willingness, and authority to purchase them. Consumer markets include purchasers and/or household members who intend to consume or benefit from the purchased products and who do not buy products to make profits. Business-to-business or industrial markets, which include producers, resellers, governments, and institutions, purchase specific kinds of products for use in making other products for resale or for day-to-day operations.

11-5 Describe the two major components of a marketing strategy—target market and marketing mix.

A marketing strategy is a plan for the best use of an organization's resources to meet its objectives. Developing a marketing strategy involves selecting and analyzing a target market and creating and maintaining a marketing mix that will satisfy the target market.

A target market is a group of individuals or organizations, or both, for which a firm develops and maintains a marketing mix suitable for the specific needs and preferences of that group. Businesses that use an undifferentiated approach design a single marketing mix and direct it at the entire market for a particular product. The market segmentation approach directs a marketing mix at a segment of a market. A market segment is a group of individuals or organizations within a market that have similar characteristics and needs. A concentrated segmentation approach directs a single marketing mix at a single market segment, while a differentiated segmentation approach directs multiple marketing mixes at multiple market segments. Marketers use a wide variety of segmentation bases.

The four elements of a firm's marketing mix are product, price, distribution, and promotion. The product ingredient includes decisions about the product's design, brand name, packaging, and warranties. The pricing ingredient is concerned with base prices and various types of discounts. Distribution involves not only transportation and storage but also the selection of intermediaries. Promotion focuses on providing information to target markets. The elements of the marketing mix can be varied to suit broad organizational goals, marketing objectives, and target markets.

11-6 Explain how the marketing environment affects strategic market planning.

Marketing activities are affected by the external forces that make up the marketing environment. These forces include economic, sociocultural, political, competitive, legal and regulatory, and technological forces. These forces influence marketing strategy decisions and can be dramatic.

11-7 Examine the major components of a marketing plan.

A marketing plan is a written document that specifies an organization's resources, objectives, strategy, and implementation and control efforts to be used in marketing a specific product or product group. The marketing plan describes a firm's current position, establishes marketing objectives, and specifies the methods the organization will use to achieve these objectives. Marketing plans can be short-range, medium-range, or long-range.

11-8 Describe how market measurement and sales forecasting are used.

Market measurement and sales forecasting are used to estimate sales potential and predict product sales in specific market segments. A sales forecast is an estimate of the amount of a product that an organization expects to sell during a certain period of time based on a specified level of marketing effort.

11-9 Explain how marketers collect and analyze information useful for marketing decision making.

Marketers require information about customers' needs and desires, marketing opportunities, and changing customer attitudes and purchase patterns, as well as changes in the marketing environment. They acquire big data from both internal and external sources, store and organize them, and analyze them. Marketing analytics—the collection, organization, and interpretation of data about marketing performance—helps them mine useful insights from the huge amounts of data they collect. This analysis can allow marketers to look at patterns of purchase and consumption to discover trends that predict future buying behaviors and thereby improve marketing strategies. When this information is insufficient for solving a problem or refining a strategy, marketers turn to marketing research. Marketing research is the process of systematically gathering, recording, and analyzing data concerning a particular marketing problem. Marketers collect primary data directly from consumers through marketing research. Secondary data are compiled inside or outside of the firm to help support marketing research initiatives.

11-10 Identify the major steps in the consumer buying decision process and the sets of factors that may influence this process.

Buying behavior consists of the decisions and actions of people involved in buying and using products. Consumer buying behavior refers to the purchase of products for personal or household use. Organizational buying behavior is the purchase of products by producers, resellers, governments, and institutions. Understanding buying behavior helps marketers predict how buyers will respond to marketing strategies. The consumer buying decision process consists of five steps: recognizing the problem, searching for information, evaluating alternatives, purchasing, and post-purchase evaluation. Factors affecting the consumer buying decision process fall into three categories: situational influences, psychological influences, and social influences. Consumer buying power is further influenced by personal, disposable, and discretionary income.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

marketing (304)
value (304)
relationship marketing (305)
customer relationship management (CRM) (305)
customer lifetime value (CLV) (307)
utility (307)
form utility (307)
place utility (307)
time utility (307)
possession utility (307)
marketing concept (308)
market (310)
marketing strategy (310)
marketing mix (310)
target market (310)
undifferentiated approach (311)
market segment (311)
market segmentation (311)
marketing plan (316)
sales forecast (317)
marketing analytics (319)
marketing research (320)
buying behavior (322)
consumer buying behavior (322)
business buying behavior (322)
personal income (324)
disposable income (324)
discretionary income (324)

Discussion Questions

1. Define marketing in your own words.
2. Why are companies so interested in relationship marketing?
3. How is a customer-oriented firm different from a production-oriented firm or a sales-oriented firm?
4. What are the major requirements for a group of individuals and organizations to be a market? How does a consumer market differ from a business-to-business market?
5. What are the major components of a marketing strategy?
6. What is the purpose of market segmentation? What is the relationship between market segmentation and the selection of target markets?
7. Describe the forces in the marketing environment that affect an organization's marketing decisions.
8. What is a marketing plan, and what are its major components?
9. What new information technologies are changing the ways that marketers keep track of business trends and customers?
10. Why do marketers need to understand buying behavior?
11. Is it a good strategy to focus most marketing efforts on the most profitable customers?
12. How might adoption of the marketing concept benefit a firm? How might it benefit the firm's customers?
13. How can marketing analytics help marketers improve marketing performance?
14. How does the marketing environment affect a firm's marketing strategy?

Case 11

Starbucks Brews Customer Satisfaction

With more than 32,000 stores across more than 80 markets, Starbucks is the world's largest coffeehouse chain. In 50 years of business, the company grew from a single coffee shop in Seattle to a booming $80 billion business that holds a 57 percent share of the U.S. café market. Zev Siegl, Jerry Baldwin, and Gordon Bowker opened the first Starbucks location in Seattle's historic Pike Place Market in 1971 under the guidance of Alfred Peet, the founder of Peet's Coffee.

Starbucks faced many challenges on its way to the top, including overexpansion and shifting consumer preferences.

Interestingly, the first Starbucks locations didn't serve coffee, selling whole and ground beans exclusively. At the time, Starbucks enticed consumers who were more accustomed to instant or canned coffee by offering high-quality beans. It wasn't until Howard Schultz joined Starbucks in the 1980s as director of retail operations and marketing that Starbucks evolved. After visiting Italy, Schultz had a vision of recreating the Italian coffeehouse concept in the United States. In 1984, the company opened its first downtown Seattle café and served the first Starbucks Caffè Latte.

The concept proved to be a success. Schultz worked with investors in 1987 to buy Starbucks for $3.8 million and pursued an aggressive expansion strategy. When the company went public in 1992, it had 265 stores. By the time Schultz left Starbucks in 2000, it had more than 2,000 locations, a number that quadrupled by 2007. At the height of its growth, it seemed there was a Starbucks on nearly every corner in densely populated urban areas. This clustering strategy proved to be a misstep that resulted in fewer transactions at individual locations. After the Great Recession began in 2007, Starbucks realized its mistake. Though people loved their daily Starbucks fix, the financial crisis caused consumers to tighten their purse strings.

With Starbucks' stock price plummeting, Schultz returned to the helm. He slowed expansion in the United States, closing redundant locations and focusing more on international growth and enhancing the customer experience. For one day, Schultz closed all U.S. stores to retrain baristas in the art of espresso to improve quality. The stores reintroduced in-house coffee grinding to bring back the café ambiance. Schultz's strategy worked, and same-store sales rebounded. It wasn't until 2012 that the company set its sights on domestic expansion once again.

Now, Starbucks is focusing on adjusting its product mix to accommodate changing consumer preferences. The Frappuccino, for example, was one of the company's most popular beverages, but a sharp drop in sales reflected the fact that consumers have become more health-conscious, moving away from sugary drinks. Starbucks has since focused on drinks such as its Refreshers and cold brew to adapt to changing consumer preferences.

Starbucks is also investing in delivery as an avenue for growth, entering into partnerships in the United States with Brightloom and Uber Eats. Online orders, especially delivery orders, tend to result in higher checks, which could be good news for Starbucks. Another major undertaking is the opening of upscale Starbucks Reserve Roastery stores. These 20,000-square foot stores, located in Shanghai, Tokyo, Manhattan, Chicago, Seattle, New York, and Milan, are designed to be tourist destinations. The roasteries serve a wide array of coffee and experiment with coffee beverages. The high-end experiential stores contribute to the so-called halo effect, which elevates Starbucks in the minds of consumers.

Under the leadership of Starbucks' current CEO Kevin Johnson, the company opened a 20,000-square foot facility called the Tryer Center at its headquarters in Seattle where employees test new concepts using rapid prototyping. Employees quickly test new concepts and deploy ideas in just a matter of months. For example, a single-cup brewing prototype was created with the lab's 3D printer and deployed a month later. Starbucks employees from every level of the business submit ideas. The innovation lab makes Starbucks more agile in developing, testing, and releasing new products and systems.

Starbucks has tackled challenges head-on on its path to the top, demonstrating its ability to identify and adapt to changes in the market. With a heightened focus on innovation, Starbucks can refine the customer experience, improve its systems and processes, and introduce new, relevant products.[20]

Questions

1. Discuss the result of Starbucks' aggressive expansion strategy.
2. In what ways has Starbucks created products that satisfy consumer wants and needs?
3. How does Starbucks support innovation?

Building Skills for Career Success

1. Social Media Exercise

Comcast, the cable and communications provider, was one of the first companies to use Twitter for customer service. The ComcastCares feed on Twitter was developed by Frank Eliason, the company's first Director of Digital Care, and is currently managed by Bill Gerth. Gerth and the Comcast team scan Twitter for complaints about service and contact the customers to see how Comcast can remedy the situation. This has altered the culture of the organization and prompted other companies to utilize Twitter for customer service. Visit @comcastcares on Twitter.

1. After exploring @comcastcares on Twitter, do you think that this helps with customer service? Why or why not?
2. Do you see other applications for Twitter for a communications giant like Comcast?

2. Building Team Skills

Review the text definitions of *market* and *target market.* Markets can be classified as consumer or industrial. Buyer behavior consists of the decisions and actions of those involved in buying and using products or services. By examining aspects of a company's products, you can determine the company's target market and the characteristics important to members of that target market.

Assignment

1. Working in teams of three to five, identify a company and a few of its most popular products.
2. List and discuss characteristics that customers may find important, including price, quality, brand name, variety of services, salespeople, customer service, special offers, promotional campaign, packaging, convenience of use, convenience of purchase, location, guarantees, store/office decor, and payment terms.
3. Write a description of the company's primary customer (target market).

3. Researching Different Careers

Before interviewing for a job, you should learn all you can about the company to help prepare you to ask meaningful questions during the interview. To find out more about a company, you can conduct market research before you interview.

Assignment

1. Choose at least two local companies for which you might like to work.
2. Contact your local Chamber of Commerce. (The Chamber of Commerce collects information about local businesses, and most of its services are free.) Ask for the information you desire.
3. Call the Better Business Bureau in your community (or check online) to determine if there are any complaints against the companies you are researching.
4. Prepare a report summarizing your findings.

Chapter 12

Especiales
Latte Freddo
4.50
HOT CHOCOLATE
MATCHA LATTE 3.00
CAFE MOCCA

ISTOCK.COM/TEMPURA

Creating and Pricing Products That Satisfy Customers

Learning Objectives

Once you complete this chapter, you will be able to:

12-1 Explain what a product is and how products are classified..

12-2 Describe the product life cycle and how it leads to new-product development.

12-3 Define product line and product mix and distinguish between the two.

12-4 Identify the methods available for managing a product mix.

12-5 Examine the uses and importance of branding, packaging, and labeling.

12-6 Describe the economic basis of pricing and the means by which sellers can control prices and buyers' perceptions of prices.

12-7 Specify the major pricing objectives used by businesses.

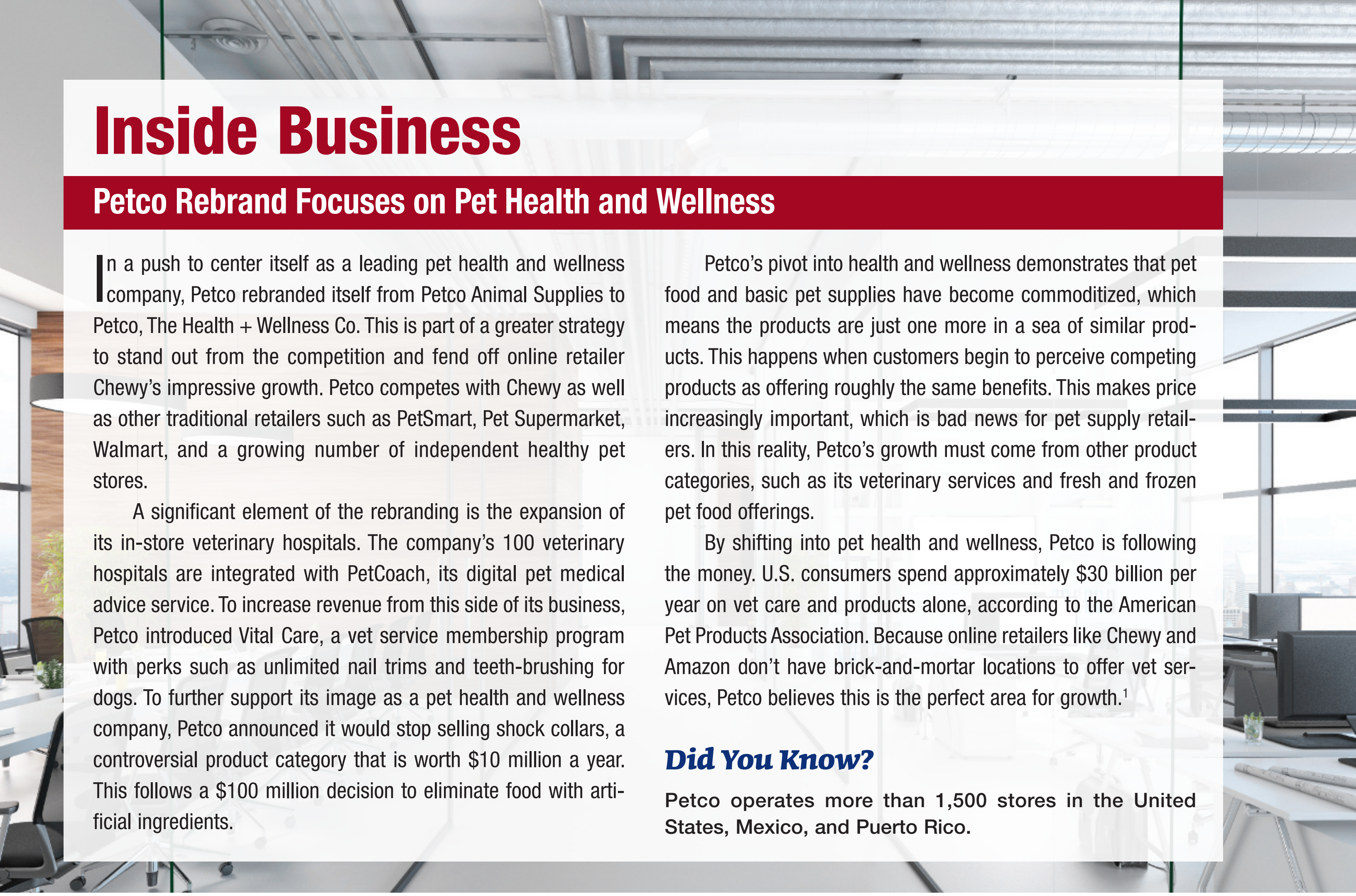
12-8 Compare the three major pricing methods that businesses employ.

12-9 Explain the different strategies available to companies for setting prices.

12-10 Recognize three major types of pricing associated with business products.

Why Should You Care?

To be successful, a businessperson must understand how to develop and manage a mix of appropriately priced products and to change the mix of products as customers' needs change.



Inside Business

Petco Rebrand Focuses on Pet Health and Wellness

In a push to center itself as a leading pet health and wellness company, Petco rebranded itself from Petco Animal Supplies to Petco, The Health + Wellness Co. This is part of a greater strategy to stand out from the competition and fend off online retailer Chewy's impressive growth. Petco competes with Chewy as well as other traditional retailers such as PetSmart, Pet Supermarket, Walmart, and a growing number of independent healthy pet stores.

A significant element of the rebranding is the expansion of its in-store veterinary hospitals. The company's 100 veterinary hospitals are integrated with PetCoach, its digital pet medical advice service. To increase revenue from this side of its business, Petco introduced Vital Care, a vet service membership program with perks such as unlimited nail trims and teeth-brushing for dogs. To further support its image as a pet health and wellness company, Petco announced it would stop selling shock collars, a controversial product category that is worth $10 million a year. This follows a $100 million decision to eliminate food with artificial ingredients.

Petco's pivot into health and wellness demonstrates that pet food and basic pet supplies have become commoditized, which means the products are just one more in a sea of similar products. This happens when customers begin to perceive competing products as offering roughly the same benefits. This makes price increasingly important, which is bad news for pet supply retailers. In this reality, Petco's growth must come from other product categories, such as its veterinary services and fresh and frozen pet food offerings.

By shifting into pet health and wellness, Petco is following the money. U.S. consumers spend approximately $30 billion per year on vet care and products alone, according to the American Pet Products Association. Because online retailers like Chewy and Amazon don't have brick-and-mortar locations to offer vet services, Petco believes this is the perfect area for growth.[1]

Did You Know?

Petco operates more than 1,500 stores in the United States, Mexico, and Puerto Rico.

Brands, like Petco, are an important way that consumers recognize products. A **product**, like Twisted Mango Diet Coke, has everything one receives in an exchange, including all tangible and intangible attributes and expected benefits. A car includes tangible benefits, such as comfortable seats, a warranty, and Apple CarPlay or Android Auto interface, as well as intangible attributes, such as status and the memories generated from road trips. Developing and managing products effectively, including these tangible and intangible benefits, are crucial to an organization's ability to maintain successful marketing mixes.

A product can be a good, a service, or an idea. A *good* is a real, physical thing that we can touch, such as an Oreo cookie. A *service* is the result of applying human or mechanical effort to a person or thing. A service is a change we pay others to make for us. A real estate agent's services result in a change in the ownership of real property. A hair stylist's services result in a change in your hairstyle. An *idea* may take the form of philosophies, lessons, concepts, or advice. Often ideas are bundled with a good or service. Thus, we might buy a book (a good) that provides ideas on how to lose weight. Alternatively, we might join Weight Watchers for ideas on how to lose weight and for help (service) in doing so.

product everything one receives in an exchange, including all tangible and intangible attributes and expected benefits; it may be a good, a service, or an idea

In this chapter, we first look at the different aspects of products. We examine product classifications and describe the four stages of the product life cycle through which every product progresses. Next, we examine how companies manage products by modifying or deleting existing ones and developing new products. We also discuss branding, packaging, and labeling. Then our focus shifts to pricing. We explain competitive factors that influence sellers' pricing decisions and explore buyers' perceptions of prices. After considering organizational objectives that can be accomplished through pricing, we outline several methods for setting prices. Finally, we describe pricing strategies by which sellers can reach target markets successfully.

12-1 Classification of Products

Learning Objective

12-1 Explain what a product is and how products are classified.

Different classes of products are directed at different target markets according to their varying needs and wants. A product's classification largely determines what kinds of distribution, promotion, and pricing are appropriate in marketing it.

Products can be grouped into two general categories: consumer and business (also called *business-to-business* or *industrial products*). A product purchased to satisfy personal and family needs is a **consumer product**. A product bought by a business for resale, for making other products, or for use in a firm's operations is a **business product**. The same item can be both a consumer and a business product, depending on the buyer's end use. LED light bulbs are a consumer product when you use them in your home, but are a business product if you purchase them for use in an office.

12-1a Consumer Product Classifications

The traditional and most widely accepted system of classifying consumer products consists of four categories: convenience, shopping, specialty, and unsought products. These groupings are based primarily on characteristics of buyers' purchasing behavior.

A **convenience product** is a relatively inexpensive, frequently purchased item for which buyers want to exert only minimal effort to procure. Examples include bread, gasoline, newspapers, soft drinks, and chewing gum. The buyer spends little time in planning the purchase of a convenience item or in comparing available brands or sellers.

A **shopping product** is an item for which buyers are willing to expend considerably more effort on planning and purchasing. Shopping products cost more than convenience products and buyers allocate ample time for comparing prices, product features, qualities, services, and warranties between different stores and brands. Appliances, upholstered furniture, men's suits, bicycles, and mobile phones are examples of shopping products. These products are expected to last for a fairly long time and thus are purchased less frequently than convenience items.

A **specialty product** possesses one or more unique characteristics for which a group of buyers is willing to expend considerable purchasing effort. Buyers know exactly what they want and will not accept a substitute. When seeking out specialty products, purchasers do not compare alternatives. Examples include unique sports cars, a rare imported beer, or original artwork.

Unsought products are those that people do not plan on purchasing, such as products that address a sudden problem or that customers are unaware of until they see them in a store or online. Emergency medical services and automobile repairs are examples of products needed quickly and suddenly to solve a problem. A consumer who is sick or injured has little time to plan to go to an emergency medical center or hospital and will find the closest location to receive service. In such cases, speed of problem resolution is more important than price or other features a buyer might normally consider if there were more time for making a decision.

consumer product a product purchased to satisfy personal and family needs

business product a product bought for resale, for making other products, or for use in a firm's operations

convenience product a relatively inexpensive, frequently purchased item for which buyers want to exert only minimal effort

shopping product an item for which buyers are willing to expend considerable effort on planning and making the purchase

specialty product an item that possesses one or more unique characteristics for which a significant group of buyers is willing to expend considerable purchasing effort

unsought product an item that people do not plan on purchasing, such as one that addresses a sudden problem or that customers are unaware of until they see it in a store or online

Consumer products can be classified into convenience, shopping, and specialty. Cheetos, a convenience product, is an item you are likely to grab off the shelf without much thought as you walk through the snack aisle of a supermarket. By contrast, people may spend a considerable amount of time and effort engaged in comparison shopping behavior when buying a shopping product, like a pair of Nike shoes.

Cheetos
Crunchy
MADE WITH REAL CHEESE!

KEITH HOMAN/SHUTTERSTOCK.COM

2P2PLAY/SHUTTERSTOCK.COM

raw material a basic material that becomes part of a physical product; usually comes from mines, forests, oceans, or recycled solid wastes

major equipment large tools and machines used for production purposes

accessory equipment standardized equipment used in a firm's production or office activities

component part an item that becomes part of a physical product and is either a finished item ready for assembly or a product that needs little processing before assembly

process material a material that is used directly in the production of another product but is not readily identifiable in the finished product

supply an item that facilitates production and operations but does not become part of a finished product

business service an intangible product that an organization uses in its operations

12-1b Business Product Classifications

Based on their characteristics and intended uses, business products can be classified into the following categories: raw materials, major equipment, accessory equipment, component parts, process materials, supplies, and services.

A **raw material** is a basic material that becomes part of a physical product. It usually comes from mines, forests, oceans, or recycled solid wastes. Raw materials are generally bought and sold according to grades and specifications.

Major equipment includes large tools and machines used for production purposes. Examples of major equipment are lathes, cranes, and stamping machines. Some major equipment is custom-made for a particular organization, but other items are standardized products that perform one or several tasks for many types of organizations.

Accessory equipment is standardized equipment used in a firm's production or office activities. Examples include hand tools, photocopiers, fractional horsepower motors, and calculators. Compared with major equipment, accessory items are usually less expensive and are purchased routinely with less negotiation.

A **component part** becomes part of a physical product and is either a finished item ready for assembly or a product that needs little processing prior to assembly. Although it becomes an element of a larger product, a component part can often be identified easily. Clocks, tires, computer chips, and switches are examples of component parts.

A **process material** is used directly in the production of another product. Unlike a component part, a process material is not readily identifiable in the finished product. Like raw materials, process materials are purchased according to industry standards or to the specifications of the individual purchaser. Examples include industrial glue and food preservatives.

A **supply** facilitates production and operations but does not become part of a finished product. Paper, pencils, oils, and cleaning agents are examples.

A **business service** is an intangible product that an organization uses in its operations. Examples include financial, legal, online, janitorial, and marketing research services. Purchasers must decide whether to provide their own services internally or to hire a contractor from outside the organization.

✓ Concept Check

- Identify the general categories of products.
- Describe the classifications of consumer products.
- Based on their characteristics, business products can be classified into what categories?

12-2 The Product Life Cycle

In a way, products are like people. They are born, they live, and they die. Every product progresses through a **product life cycle**, a series of stages in which a product's sales revenue and profit increase, reach a peak, and then decline. A firm must be able to launch, modify, and delete products from its offering in response to changes in product life cycles. Otherwise, the company's profits will disappear, and the firm will fail. Depending on the product, life-cycle stages vary in length. In this section, we discuss the stages of the life cycle and how marketers can use this information.

Learning Objective

12-2 Describe the product life cycle and how it leads to new-product development.

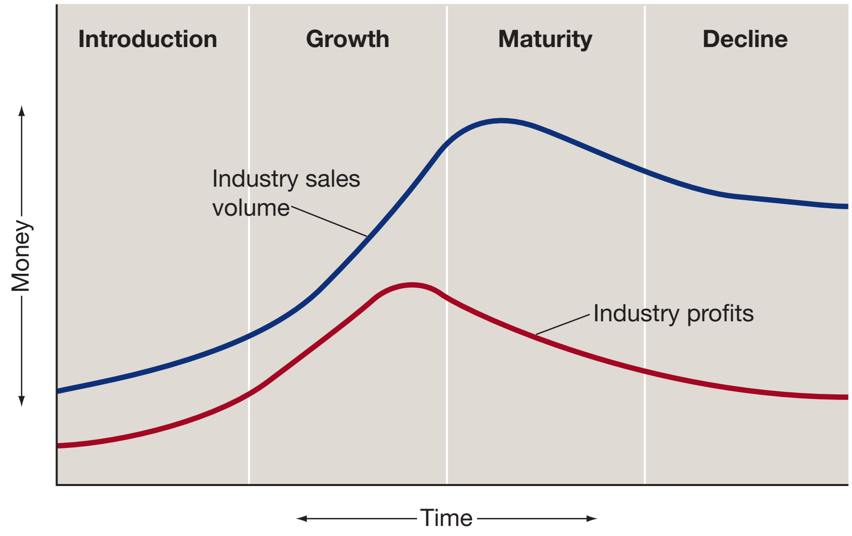
12-2a Stages of the Product Life Cycle

Generally, the product life cycle is composed of four stages—introduction, growth, maturity, and decline—as shown in Figure 12-1. Some products progress through these stages rapidly, in a few weeks or months, while others can take years. The Koosh Ball, popular in the late 1980s, had a short life cycle. In contrast, Parker Brothers' Monopoly game, which was introduced nearly a century ago, is still going strong.

Introduction In the *introduction stage*, customer awareness and acceptance of the new product are low. Sales rise gradually as a result of promotion and distribution activities. There are no competitors at this stage. High development and marketing costs result in low profit, or even in a loss, initially. The price can be high as the company recoups research and development expenses and ramps up production. Customers are primarily people who want to be at the forefront of owning the new product. Examples of products in the introductory stage include self-driving cars and smart glasses such as Amazon's Echo frames. The marketing challenge at this stage is to make potential customers aware of the product's existence and its features, benefits, and uses. Marketers may make the product available to social media influencers so that they will share information about the product with their followers.

Figure 12-1 **Product Life Cycle**

The graph shows sales volume and profits during the life cycle of a product.



product life cycle a series of stages in which a product's sales revenue and profit increase, reach a peak, and then decline

A new product is seldom an immediate success. Marketers must monitor early buying patterns and be prepared to modify the product promptly if necessary. The company should attempt to price the product to attract the market segment that has the greatest desire and ability to purchase it. Plans for distribution and promotion should suit the targeted market segment. All ingredients of the marketing mix may need to be adjusted quickly to maintain sales growth during the introduction stage.

Growth In the *growth stage*, sales increase rapidly as consumers gain awareness of the product. Other companies have begun to market competing products. The competition and decreased unit costs (owing to mass production) result in a lower price, which reduces the profit per unit. Industry profits reach a peak and begin to decline during this stage. To meet the needs of the growing market, the originating firm offers modified versions of the product and expands distribution. Virtual reality headsets, esports, and products with CBD are currently in the growth stage.

Marketers' goal in the growth stage is to stabilize and strengthen the product's position by encouraging brand loyalty. To beat the competition, the company may further improve the product or expand the product line to appeal to additional market segments. For example, to compete with the Amazon Echo smart speaker with Alexa the voice assistant, Google and Apple introduced their own smart speakers with voice assistants aimed at capturing different market segments and gaining market share in the growing industry.

A firm also may compete by lowering prices if increased production efficiency has resulted in sufficient savings. As the product becomes more widely accepted,

Sustaining the Planet

Consumers Go Flexitarian with Fake Meat

The alternative protein category has experienced skyrocketing growth in recent years with the widespread availability of brands such as Beyond Meat and Impossible Foods. Supply chain disruptions during the COVID-19 pandemic led many consumers to try so-called fake meat products for the first time in the face of meat shortages. According to research from Archer Daniels Midland, one of the world's largest food producers, 97 percent of people who tried plant-based meat substitutes for the first time during the pandemic intend to purchase them again.

Many plant-based meat substitute brands found themselves in the right place at the right time during the pandemic. For example, Impossible Foods was able to adjust its distribution strategy when the global health crisis struck, speeding up retail expansion and getting its plant-based burger meat alternative into thousands of grocery stores nationwide. This was paired with major food chains, such as Starbucks, Burger King, Dunkin', KFC, and Qdoba, introducing menu items featuring alternative meats.

Though Americans aren't becoming full-fledged vegetarians in large numbers, there is a significant trend toward a flexitarian diet, which is a veggie-centric way of eating. Consumers often cite health, safety, and convenience as top reasons for eating meat alternatives, while others believe that eating a plant-based diet is better for the planet. According to the Vegetarian Society, eating vegetarian results in 2.5 times fewer carbon emissions than a meat-based diet. Additionally, the meat industry uses a significant amount of land and water to raise cattle.

Regardless of the reason for seeking out meat alternatives, the meatless-meat trend is here to stay. Even meat processors such as Tyson and Perdue have jumped on the meat alternative bandwagon. Explosive sales during quarantine proved that meat alternatives can be profitable, and consumers are willing to experiment with new products in the category.

Sources: Based on information in T. L. Stanley, "Lockdown Fake Meat Buyers Turned Into Full-Blown Plant-Based Converts," *Adweek*, October 30, 2020, www.adweek.com/brand-marketing/lockdown-fake-meat-buyers-plant-based-converts; Vegetarian Society, "Eat to Beat Climate Change," https://vegsoc.org/info-hub/why-go-veggie/environment; Rhian Hunt, "Can't Find Burger Meat? Kroger Stocks Impossible Burgers in 1,700 Stores," *USA Today*, May 6, 2020, www.usatoday.com/story/money/2020/05/06/kroger-stocks-impossible-burgers-in-1700-stores/111663724.

marketers may be able to broaden the network of distributors. Marketers can also emphasize customer service and prompt credit for defective products. During this period, promotional efforts attempt to build brand loyalty among customers.

Maturity Sales are still increasing at the beginning of the *maturity stage*, but the rate of increase has slowed. Later, the sales curve peaks and begins to decline, as do industry profits. Product lines are simplified, markets are segmented more carefully, and price competition increases, which forces weaker competitors to leave the industry. Marketers continue to introduce refinements and extensions of the original product to the market, like Samsung's folding Galaxy smartphone. Yes, smartphones have entered the maturity stage.

During a product's maturity stage, its market share may be strengthened by redesigned packaging or style changes. As an example, J.M. Smucker Company introduced Jif peanut butter in squeezable upright pouches to give consumers more flexibility when using the product. The new package lets consumers spread the product without a knife, measure precise amounts for recipes, or facilitate children serving themselves.[2] Redesigned packaging may convince consumers to use the product more often or in new ways, improving flagging sales.

Pricing strategies are flexible during the maturity stage. Markdowns and price incentives are not uncommon, although price increases may work to offset production and distribution costs. Marketers may offer incentives and assistance of various kinds to dealers to encourage them to support mature products, especially in the face of competition from private-label brands. New promotional efforts and aggressive personal selling may be necessary during this period of intense competition.

50¢
1-888-
Dial4Less
5 MINUTOS

ROBERT GREGORY GRIFFETH/SHUTTERSTOCK.COM

Saying “goodbye” to the pay telephone. The pay telephone is in the decline stage of the product life cycle. Do you recall seeing one? If so, when and where? You might have a hard time remembering.

Decline During the *decline stage*, sales volume decreases sharply, and profits continue to fall. The number of competing firms declines, and the only survivors in the marketplace are businesses that specialize in marketing the product. Production and marketing costs become the most important determinant of profit. Mp3 players and landlines are examples of declining products.

When a product adds to the success of the overall product line, the company may retain it. Otherwise, marketers must determine when to eliminate it. A product usually declines because of technological advances, environmental factors, or consumers switching to alternative products. Therefore, few changes are made in the product itself during this stage. Instead, managers may raise the price to cover costs, reprice to maintain market share, or lower the price to reduce inventory. They will narrow distribution to the most profitable existing markets. During this period, the company probably will not spend heavily on promotion, although it may use some advertising and sales incentives to slow the product's decline. The company may choose to eliminate less-profitable versions of the product from the product line or may decide to drop the product entirely. Coca-Cola, for example, discontinued its Tab diet soft drink as part of a companywide strategic culling of underperforming products and brands. The nearly 60-year-old Tab brand languished after the introduction of Diet Coke, which went on to become one of Coca-Cola's best-selling soft drinks.[3]

12-2b Using the Product Life Cycle

When making marketing strategy decisions, managers must be aware of the life-cycle stage of each product for which they are responsible and to estimate how long the product is expected to remain in that stage. For example, if a product is expected to remain in the maturity stage for a long time, there is no rush to develop a replacement product. A company risks speeding the decline of an existing product by releasing a replacement before the earlier product has reached the decline stage. Even so, a firm will be willing to take that risk in some cases. In other situations, a company will attempt to extend a product's life cycle. Extending its life can be an important tool in maintaining a product's profitability. A condiment staple since its introduction more than 140 years ago, Heinz Ketchup has extended its life through packaging innovations, such as squeeze bottles and single-serving containers, releasing different flavors like balsamic and sriracha, and even experimenting with purple and green-colored ketchup.

✓ Concept Check

- Explain the four stages of the product life cycle.
- How does knowledge of the product life cycle relate to the introduction of new products?

12-3 Product Line and Product Mix

Learning Objective

12-3 Define *product line* and *product mix* and distinguish between the two.

A **product line** is a group of similar products that differ only in relatively minor characteristics. Generally, the products within a product line are related to each other in the way they are produced, marketed, or used. Procter & Gamble, for example, manufactures and markets several shampoos, including Pantene, Head & Shoulders, and Herbal Essences.

While organizations may start a new product line, many opt to introduce new products within existing product lines. It is less costly than starting a new product line and permits them to apply the experience and knowledge they have acquired to the production and marketing of new products. FritoLay, for example, regularly introduces new flavors of its popular potato chips, such as Flamin' Hot and Kettle Cooked Jalapeno.

An organization's **product mix** consists of all the products the firm offers for sale. For example, Procter & Gamble has about 60 brands—some of which are well known, like Gillette and Febreze, and others that are less familiar in the United States, such as Lenor and Ariel—that fall into several product lines.[4] Two "dimensions" are often applied to a firm's product mix. The *width* of the mix is the number of product lines it contains. The *depth* of the mix is the average number of individual products within each line. These measures are general—no exact numbers correspond to these categories. Some organizations offer a broad product mix as a means of trying to be competitive in many different categories.

✓ Concept Check

- How does a product line differ from a product mix?
- Can a product line be a product mix?

12-4 Managing the Product Mix

Learning Objective

12-4 Identify the methods available for managing a product mix.

To provide products that satisfy people in a firm's target market or markets and that also achieve the organization's objectives, a marketer must develop, adjust, and maintain an effective product mix. The same product mix is rarely effective for long. As customers' product preferences and attitudes change, their desire for a product may diminish or grow. A company may also need to alter its product mix to adapt to changes in the competition. For example, a marketer may have to introduce a new product, modify an existing one, or eliminate a product from the mix because one or more competitors have grown more dominant in the market segment. A marketer may also expand the firm's product mix to take advantage of excess marketing and production capacity. Panera, for instance, introduced three flavors of flatbread pizzas to help bring customers into its casual dining restaurants at dinnertime.[5] A company must be careful when altering the product mix that the

product line a group of similar products that differ only in relatively minor characteristics

product mix all the products a firm offers for sale changes made bring about improvements in the mix. There are three major ways to improve a product mix: change an existing product, delete a product, or develop a new product.

TOSHIO CHAN/SHUTTERSTOCK.COM

Part of a product line. These products are part of Lay's potato chip product line.

12-4a Managing Existing Products

A product mix can be changed by deriving additional products from existing ones. This can be accomplished through product modifications and by line extensions.

Product Modifications **Product modification** refers to changing one or more of a product's characteristics. For this approach to be effective, several conditions must be met. First, the product must be modifiable. Second, existing customers must be able to perceive that a modification has been made, assuming that the modified item is still directed at the same target market. Third, the modification should make the product more consistent with customers' desires so that it provides greater satisfaction. For example, after being acquired by Ferrero Group, Keebler reformulated a number of its cookies to capitalize on the growing consumer demand for "cleaner" foods. The company replaced high-fructose corn syrup and artificial vanilla with more natural ingredients. It also redesigned the packaging to improve freshness, highlight the ingredient changes, and unify designs across the Keebler brand.[6]

Existing products can be altered in three primary ways: in quality, function, and aesthetics. *Quality modifications* are changes that relate to a product's dependability and durability and are usually achieved by alterations in the materials or production process. *Functional modifications* affect a product's versatility, effectiveness, convenience, or safety. They usually require redesign of the product. Typical product categories that have undergone extensive functional modifications include home appliances, office and farm equipment, and consumer electronics. *Aesthetic modifications* change the sensory appeal of a product by altering its taste, texture, sound, smell, or visual characteristics. Because a buyer's purchasing decision is affected by sensory stimuli, an aesthetic modification may impact purchases. Through aesthetic modifications, a company can differentiate its product from competing brands and gain market share if customers find the modified product more appealing.

product modification the process of changing one or more of a product's characteristics

line extension development of a new product that is closely related to one or more products in the existing product line but designed specifically to meet somewhat different customer needs

Line Extensions A **line extension** is the development of a product closely related to one or more products in the existing product line but designed specifically to meet somewhat different customer needs. For example, Hostess Brands introduced new flavors of its perennial snack cakes, including caramel-filled Ding Dongs and mixed berry Twinkies, as well as several holiday themed versions of Twinkies, Hostess CupCakes, SnoBalls, and Donettes.[7]

Many of the so-called new products introduced each year are in fact line extensions. Line extensions are more common than new products because they are a less-expensive, lower-risk alternative for increasing sales. A line extension may focus on a different market segment or be an attempt to increase sales within the same market segment by more precisely satisfying that segment's needs, hopefully taking away market share from competitors.

TONELSONPRODUCTIONS/SHUTTERSTOCK.COM

Line extensions help companies to be more competitive and to maintain or increase their market shares. There are 40 flavors of Oreos in the United States, and more than 85 worldwide. Each flavor is a line extension derived from the original product.

Exploring Careers

Are You Ready for a Career in Product Management?

Product managers are responsible for coordinating activities related to understanding customers' needs, the development of products, and product design. While product managers are not necessarily charged with product development specifically, they guide decision making across teams by communicating customer pain points and helping identify solutions. Product managers may come from a variety of backgrounds, which creates many types of product management.

Customer-focused product managers often have a background in sales or customer support and are focused on how to best serve the needs of customers. These product managers ask questions such as "Who is the customer?" "What is the customer problem or opportunity?" and "What does the customer experience look like?" On the other end of the spectrum is business-focused product management. These managers usually have a sales background and focus on how to develop, fund, and improve products and how the products will affect the business.

Technical product managers come from the areas of information technology and software engineering and focus on how a product is developed. These managers work on technical products such as Software-as-a-Service (SaaS, a software licensing and delivery model) products. Lastly, design-focused product managers focus on elements such as packaging, labeling, and functionality. Many more types of product managers exist, and more often than not, these types of product management blend together. Apple, for instance, hires product managers to drive design and work with engineering to differentiate its customer-centric products.

There is no "one size fits all" career path to becoming a product manager, so there are several ways to enter the field. Regardless of their background, a product manager must be a team player with a creative mind and excellent communication, organization, problem-solving, interpersonal, and technical skills. Technical skills, such as the ability to develop product strategies, are learned along the way.

Sources: Based on information in Kristen Baker, "How to Start Your Career in Product Management," *Hubspot,* November 6, 2019, https://blog.hubspot.com/service/product-management; Karthik Sankar, "How to Do Customer-Focused Product Management," *Products That Count,* April 13, 2020, www.productsthatcount.com/how-to-do-customer-focused-product-management; Roi Lavan, "Are You an Apple-Like or Google-Like Product Manager," *Medium,* February 22, 2017, www.medium.com/@roilavan/are-you-an-apple-like-or-google-like-product-manager-4628c8db69c4.

12-4b **Deleting Products**

To maintain an effective product mix, an organization often has to eliminate some products. This is called **product deletion**. A weak and unprofitable product costs a company time, money, and resources that could be used to modify other products or develop new ones. A weak product's unfavorable image can negatively affect the customer perception and sales of other products sold by the firm.

Most organizations find it difficult to delete a product because of the costs associated with bringing the product to market or for more emotional reasons. Some companies drop weak products only after they have become severe financial burdens. A better approach is to conduct a systematic review of the product's impact on the overall effectiveness of a firm's product mix. Such a review should analyze a product's contribution to a company's sales for a given period and should include estimates of future sales, costs, and profits. This review should help a firm to determine whether changes in the marketing strategy might improve the product's performance.

A product-deletion program can improve a company's performance. The Canadian aircraft maker Bombardier surprised the aviation world when it announced that it would stop selling Learjet small private aircraft, which have seen declines in demand and profits in recent years. Celebrities and wealthy customers have been turning away from the 60-year-old brand in recent years in favor of larger, more long-range aircraft. Discontinuing Learjet will allow the company to cut costs and

product deletion the elimination of one or more products from a product line improve cash flow, which the company will channel into its more lucrative, larger business jet aircraft.[8]

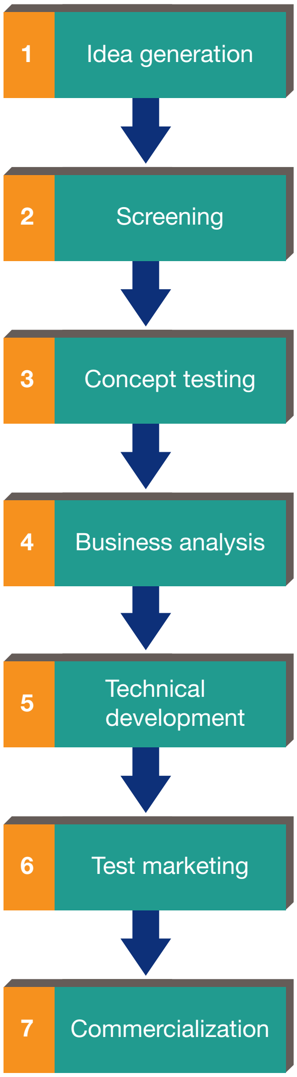
12-4c Developing New Products

Developing and introducing new products is frequently time consuming, expensive, and risky. Joby Aviation, for example, has spent a decade and more than $100 million developing a fast, electric air taxi that it hopes one day will compete with Uber and Lyft for short trips.[9] Thousands of new products are introduced annually. For most firms, more than half of new products will fail. Although developing new products is risky, failing to introduce new products can be just as hazardous. Successful new products can produce benefits for an organization, including survival, profits, a sustainable competitive advantage, and a favorable public image.

New products are generally grouped into three categories on the basis of their degree of similarity to existing products. *Imitations* are products designed to compete with existing products of other companies. The success of Mark Anthony Brand's White Claw hard seltzer, for instance, spawned many competitors such as Truly (Boston Beer), Bud Light Seltzer (Anheuser-Busch InBev), and Vizzy (Molson Coors). *Adaptations* are variations of existing products that are intended for an established market. Product refinements and line extensions are the adaptations considered most often, although imitative products may also include some refinement and extension. *Innovations* are entirely new products. They may give rise to a new industry or disrupt an existing one, like Chime's no-fee, app-based financial service did for the banking industry. Innovative products take considerable time, effort, and money to develop. They are by far the riskiest new product to develop and launch and are therefore less common than adaptations and imitations. While other companies market basic hair straighteners that cost $13–$200, the $500 Dyson Corrale flat iron uses proprietary technology and design that makes it operate cooler and safer, easier to use, and less damaging to hair. Dyson spent seven years and $43 million dollars developing the new product.[10] As shown in Figure 12-2, the process of developing a new product consists of seven phases.

Figure 12-2 **Phases of New-Product Development**

Generally, marketers follow these seven steps to develop a new product.



Idea Generation Idea generation involves looking for product ideas that will help a firm achieve its objectives. Although some organizations get their ideas almost by chance, companies trying to maximize product-mix effectiveness develop systematic approaches for generating new-product ideas. Ideas may come from virtually any stakeholder associated with the firm, including managers, employees, researchers, engineers, competitors, advertising agencies, management consultants, private research organizations, customers, salespersons, or top executives. Sometimes, large companies with superior experience and resources may mentor small firms and help them generate ideas to help their businesses grow. Business incubators exist all over the country that pair new businesses with established ones so that the new business can learn about marketing and branding from experts. Goldman Sachs, Walmart, Chase Bank, and Staples have all hosted events and programs to counsel start-ups. Jim Koch of Boston Beer Company, maker of Sam Adams, partners with the small business lender, Accion, for the Brewing the American Dream program, which offers speed coaching sessions and loans to small businesses.[11]

Screening During screening, ideas that do not match organizational resources and objectives are rejected. In this phase, a firm's managers consider whether the organization has the financial resources and personnel with the correct expertise to develop and market the proposed product. Additionally, the company will assess whether the idea can address some need or want of buyers. Marketers may reject a good idea because the company lacks the necessary skills and abilities to make the product a success or because there is no apparent market for the product. The largest number of product ideas is rejected during the screening phase.

MOMA OKGO/SHUTTERSTOCK.COM

New product. Apple AirPods Pro are a new product that allow users to connect wirelessly to their cell phones through Bluetooth technology. There are also different levels of noise cancellation that now allow you to be fully in tune with your music, podcasts, and calls whenever and wherever you desire.

Concept Testing Concept testing is a phase in which a product idea is presented to a sample of potential buyers through a written or oral description (and perhaps drawings) to determine their attitudes and initial buying intentions. An organization may test one or several concepts when developing a product idea. Concept testing is a low-cost means for an organization to determine consumers' initial reactions to an idea before investing considerable resources in product research and development (R&D). Product development personnel use the results of concept testing to make product attributes and benefits reflect the characteristics and features most important to potential customers. The questions asked vary considerably depending on the type of product idea being tested. The following are typical:

- Which benefits of the proposed product are especially attractive to you?
- Which features are of little or no interest to you?
- What are the primary advantages of the proposed product over the one you currently use?
- If this product were available at an appropriate price, how often would you buy it?
- How could this proposed product be improved?

Business Analysis Business analysis generates tentative ideas about a potential product's financial performance, including profitability. During this stage, the firm considers how the new product, if it were introduced, would affect the firm's overall sales, costs, and profits. Marketing personnel usually work up preliminary sales and cost projections at this point, with the help of R&D and production managers.

Technical Development In the technical development phase, the company must determine whether it is technically feasible to produce the product and if the product can be made at a low enough cost for the company to generate a profit. If a product idea makes it to this point, it is transformed into a working model, or *prototype*. Often, this step is time consuming and expensive for the organization. When James Dyson was working to invent his first cyclonic, bagless vacuum cleaner, he went through more than 5,000 prototypes before he found the right one; his company continues to go through many prototypes throughout the research and development process of creating new products that solve problems.[12] If a product moves through this step successfully, then it is ready for test marketing.

Test Marketing Test marketing is the limited introduction of a product in several towns or cities that are representative of the intended target market. Its aim is to determine buyers' probable reactions. Marketers experiment with advertising, pricing, and packaging in different test markets and measure the extent of brand awareness, brand switching, and repeat purchases that result from alterations in the marketing mix. As an example, Chick-fil-A, test marketed a new Honey Pepper Pimento Chicken sandwich in restaurants in some cities in North and South Carolina. The fast-food chain has been testing new chicken sandwich flavors to broaden its appeal and compete with new chicken sandwich offerings from Popeyes, KFC, and even McDonald's.[13]

Commercialization During commercialization, the organization completes plans for full-scale manufacturing and marketing and prepares project budgets. In the

Technology and Innovation

High-Tech Is High Fashion

By and large, the fashion industry is incredibly unsustainable. Fast fashion—mass-producing low-priced, trendy clothing at a low cost—in particular, comes at an extraordinary environmental cost. According to the World Economic Forum (WEF), the fashion industry emits more carbon than international flights and maritime shipping combined. Improvements driven by new technologies, however, have the power to turn the industry around.

Major brands are pledging to make sustainability a greater priority. Zara, one of the largest fast-fashion brands, pledged to use only organic, sustainable, or recycled cotton, linen, and polyester by 2025. By the same year, Nike said its plants will be powered by 100 percent renewable energy. Other companies, such as Wrangler, have developed new processes that reduce or eliminate water waste.

Many of these changes are enabled by advances in technology. Consumers are demanding that fashion brands become more transparent with their supply chains. They want to know where and how clothing is made. To achieve this, some brands have begun using blockchain technology to track their supply chains. For example, H&M partnered with VeChain to provide consumers with detailed supply chain tracing data. With just a click, consumers can view the suppliers and factories that contributed to a particular piece of clothing. With blockchain technology, the ledger creates permanent, time-stamped records of each step in a product's journey.

It can be challenging for companies to measure their social and environmental impact, but the growing demand for social accounting has given rise to new technology that will make it easier. Google Cloud partnered with designer Stella McCartney to create a tool powered by data analytics and machine learning to help do just that. The tool will give companies better insights into the environmental impact of their production processes.

Sustainability is the future of fashion. Circular business models, which aim to reduce waste through the continual use of resources, as well as supply chain tracing will become mainstream in the long run as technology accelerates. Consumers increasingly demand transparency, sustainability, and accountability across industries, and fashion is no exception.

Sources: Based on information in Nell Lewis and Max Burnell, "Look and Feel Good: How Tech Could Save the Fashion Industry," *CNN,* September 30, 2019, www.cnn.com/2019/09/27/business/technology-fashion-sustainability/index.html; Morgan McFall-Johnsen, "These Facts Show How Unsustainable the Fashion Industry Is," *World Economic Forum,* January 31, 2020, www.weforum.org/agenda/2020/01/fashion-industry-carbon-unsustainable-environment-pollution; "H&M Head of Sustainability Praises VeChain's Traceability Solution," *Crypto News Flash,* September 1, 2020, www.crypto-news-flash.com/hm-head-of-sustainability-praises-vechains-traceability-solution.

early part of the commercialization phase, marketing management analyzes the results of test marketing to determine necessary changes in the marketing mix. Test marketing may reveal, for example, that marketers need to change the product's physical attributes, modify the distribution plan, alter promotional efforts, or change the price. Most new products are marketed in stages, beginning in selected geographic areas and expanding into adjacent areas over a period of time.

12-4d **Why Do Products Fail?**

Despite this rigorous process for developing product ideas, most new products end up as failures. In fact, many well-known companies have produced market failures (refer to Table 12-1).

Why does a new product fail? Mainly because the product and its marketing program are not planned and tested as thoroughly as they should be. For example, Samsung's Galaxy Note S7 phablet—a supersized smartphone—failed because some of the phones' batteries caught on fire. After the phones were banned from domestic flights, Samsung recalled the phones and ultimately opted to discontinue the model rather than lose more money on its investment.[14] To save on development costs, a firm may market-test a product before the kinks are worked out, or may not test its entire marketing mix. Or, when problems show up in the testing stage, a

Concept Check

- What are some ways to improve a product mix? Describe two approaches to use existing products to strengthen a product mix.
- Why is it important to delete certain products? The largest number of product ideas are rejected during which stage?
- What is the aim of test marketing?
- Describe the seven phases of new-product development.

Table 12-1 **Examples of Product Failures**

Company	Product
Microsoft	Zune (2006)
Apple	Newton (1993)
Amazon	Fire Phone (2014)
Coca-Cola	New Coke (1985)
Frito-Lay	WOW! Chips (1998)

Sources: Adapted from: "When Corporate Innovation Goes Bad—The 160 Biggest Product Failures of All Time," *CBInsights,* April 7, 2020, https://www.cbinsights.com/research/corporate-innovation-product-fails/ (accessed March 18, 2021); Ben Gilbert, "25 of the Biggest Failed Product from the World's Biggest Companies," *Business Insider*, October 17, 2019, https://www.businessinsider.com/biggest-product-flops-in-history-2016-12 (accessed March 18, 2021).

company may try to recover its product development costs by pushing ahead with full-scale marketing anyway. Finally, some companies try to market new products with inadequate financing.

12-5 Branding, Packaging, and Labeling

Learning Objective

12-5 Examine the uses and importance of branding, packaging, and labeling.

Three important features of a product (particularly a consumer product) are its brand, package, and label. These features may be used to associate a product with a successful product line or to distinguish it from existing products. They may be designed to attract customers at the point of sale or to provide information to potential buyers. Because the brand, package, and label are integral elements of the product, they deserve careful attention during product planning.

12-5a What Is a Brand?

A **brand** is a name, term, symbol, design, or any combination that identifies a seller's products and distinguishes it from other sellers' products. A **brand name** is the part of a brand that can be spoken. It may include letters, words, numbers, or pronounceable symbols, such as the ampersand in *Procter & Gamble*. A **brand mark**, on the other hand, is the part of a brand that is a symbol or distinctive design, such as the Nike "swoosh." A **trademark** is a brand name or brand mark that is registered with the U.S. Patent and Trademark Office and thus is legally protected from use by anyone except its owner. A **trade name** is the complete and legal name of an organization, such as Pizza Hut or Cengage (the publisher of this text).

12-5b Types of Brands

Brands are often classified according to who owns them: manufacturers or stores. A **manufacturer (**or **producer) brand**, as the name implies, is a brand that is owned by the manufacturer. Many foods (Kellogg's Frosted Flakes), major appliances (Whirlpool), gasolines (Chevron), automobiles (Honda), and clothing (American Eagle) are sold as manufacturers' brands. Some consumers prefer manufacturer brands because they are usually nationally known, offer consistent quality, and are widely available.

A **store (**or **private) brand** is a brand that is owned by an individual wholesaler or retailer. Among the better-known store brands are Cat & Jack (Target), Kirkland Signature (Costco), and Trader Joe's. Owners of store brands claim that they can offer lower prices, earn greater profits, and improve customer loyalty by offering their own brands. Target, the first company to have ten billion-dollar store brands, uses them to help distinguish itself from rivals and to build loyalty among customers.[15]

brand a name, term, symbol, design, or any combination of these that identifies a seller's products as distinct from those of other sellers

brand name the part of a brand that can be spoken

brand mark the part of a brand that is a symbol or distinctive design

trademark a brand name or brand mark that is registered with the U.S. Patent and Trademark Office and thus is legally protected from use by anyone except its owner

trade name the complete and legal name of an organization

manufacturer (or **producer) brand** a brand that is owned by a manufacturer

store (or **private) brand** a brand that is owned by an individual wholesaler or retailer

Some companies that manufacture private brands also produce their own manufacturer brands. They often find such operations profitable because they can use excess capacity and avoid most marketing costs. Many private-branded grocery products are produced by companies that specialize in making private-label products. Most supermarkets rely heavily on their store brands. In the United States, store brands account for about 18 percent of all consumer packaged goods sales, and these private brand sales are rising faster than large manufacturer brand sales.[16]

A **generic product** (sometimes called a **generic brand**) is a product with no brand at all. Its plain package carries only the name of the product—applesauce, peanut butter, or potato chips. Generic products, available in supermarkets since 1977, are sometimes made by the major producers that manufacture name brands.

pop tarts
Raspberry
Cinnamon Roll
Cherry
Brown Sugar Cinnamon
Blueberry
MORE FROSTING!
8

SHEILA FITZGERALD/SHUTTERSTOCK.COM

You can easily recognize a manufacturer's brand because it is not sold by just one retailer. This brand was initiated by the manufacturer and is owned and supported by the manufacturer. Pop-Tarts are sold in many supermarkets.

12-5c Benefits of Branding

Consumer confidence is the most important element in the success of a branded product, whether the brand is owned by a producer or by a retailer. Because branding identifies each product, customers can easily repurchase products that provide satisfaction, performance, and quality. Moreover, they can just as easily avoid or ignore unsatisfactory products. In supermarkets, the products most likely to keep their shelf space are the brands with large market shares and strong customer loyalty.

Both buyers and sellers benefit from branding. Because brands are easily recognizable, they reduce the amount of time buyers spend on shopping, as they can quickly identify the brands they prefer. Choosing particular brands, such as Chanel, Polo, Patagonia, or Nike, can be a way of expressing oneself and identifying with certain lifestyle characteristics and values. Brands also help reduce the perceived risk of purchase. Finally, customers may receive a psychological reward from owning a brand that symbolizes status. The Lexus brand is an example.

Branding helps a firm introduce a new product that carries a familiar brand name because buyers already know the brand. Branding aids sellers in their promotional efforts because promotion of each branded product indirectly promotes other products of the same brand. H.J. Heinz, for example, markets many products with the Heinz brand name, such as ketchup, vinegar, gravies, barbecue sauce, and steak sauce.

One chief benefit of branding is the creation of **brand loyalty**, the extent to which a customer is favorable toward buying a specific brand. The stronger the brand loyalty, the greater is the likelihood that buyers will consistently choose the brand. There are three levels of brand loyalty: recognition, preference, and insistence. *Brand recognition* is the level of loyalty at which customers are aware that the brand exists and will purchase it if their preferred or familiar brands are unavailable. This is the weakest form of brand loyalty. *Brand preference* is the level of brand loyalty at which a customer prefers one brand over competing brands. However, if the preferred brand is unavailable, the customer is willing to substitute another brand. *Brand insistence* is the strongest and least common level of brand loyalty. Brand-insistent customers will not buy substitutes. Apple is a brand known for having brand-insistent customers. Every time Apple releases a new product, customers will stand in line for hours, even days, just to be among the first to purchase it. Brand loyalty in general seems to be declining, partly due to marketers' increased dependence on discounted prices, coupons, and other short-term promotions, and partly because of the enormous array of new products with similar characteristics. It is also easier than ever to comparison shop for products that meet customers' needs at the lowest possible price.

generic product (or **generic brand)** a product with no brand at all

brand loyalty extent to which a customer is favorable toward buying a specific brand

Table 12-2 Top Ten Most Valuable Brands in the World

Brand	Brand Value (billion $)
1. Apple	323.0
2. Amazon	200.7
3. Microsoft	166.0
4. Google	165.4
5. Samsung	62.3
6. Coca-Cola	56.9
7. Toyota	51.6
8. Mercedes-Benz	49.3
9. McDonald's	42.8
10. Disney	40.8

Source: "Best Global Brands Rankings," *Interbrand*, https://interbrand.com/best-global-brands/ (accessed March 18, 2021).

Brand equity is the marketing and financial value associated with a brand's strength in a market. Although difficult to measure, brand equity represents the value of a brand to an organization. The top ten most valuable brands in the world are shown in Table 12-2. The four major factors that contribute to brand equity are brand awareness, brand associations, perceived brand quality, and brand loyalty. Brand awareness leads to brand familiarity—buyers are more likely to select a familiar brand. The symbolic associations of a brand connect it to a personality type or lifestyle. For example, customers associate Michelin tires with protecting family members, Nike products with pushing yourself athletically ("Just Do It"), and Dr Pepper with a unique taste. When consumers are unable to judge for themselves the quality of a product, they may rely on a brand's perceived level of quality. Finally, brand loyalty is a valued element of brand equity because it reduces both a brand's vulnerability to competitors and the need to spend tremendous resources to attract new customers. Loyalty also increases brand visibility and encourages retailers to carry the brand. Sometimes, large firms opt to purchase a well-known brand to diversify or complement their existing brands. As an example, Mohawk Group, a consumer products conglomerate, acquired the Spiralizer, PurSteam, and Pohl Schmitt brands in order to diversify its portfolio of brands with small appliance options.[17]

12-5d Choosing and Protecting a Brand

A number of issues should be considered when selecting a brand name. The name should be easy for customers to say, spell, and recall. Short, one-syllable names such as *Tide* often satisfy this requirement. Words, numbers, and letters can be combined to yield brand names such as Samsung's Galaxy S21 Ultra phone or BMW's Z4 Roadster. The brand name should suggest, in a positive way, the product's uses, special characteristics, and major benefits, and should be distinctive enough to set it apart from competing brands.

It is important that a company select a brand that can be protected through registration, reserving it for exclusive use by that firm. Some brands, because of their designs, are infringed on more easily than others. Registration protects trademarks domestically for ten years and can be renewed indefinitely. To protect its exclusive right to the brand, the company must ensure that the selected brand will not be considered an infringement on any existing brand already registered with the U.S. Patent and Trademark Office. This task may be complicated by the fact that courts determine infringement and base their decisions on whether a brand causes consumers to be confused, mistaken, or deceived about the source of the product. McDonald's is one company that is known for aggressively protecting its trademarks against infringement. It has brought charges against a number of companies with *Mc* names because of concerns that the use of the prefix might give consumers the impression that these companies are associated with or owned by McDonald's.

A business does not want a brand name to become a generic term that refers to a general product category. Generic terms cannot be legally protected as exclusive brand names. For example, names such as *yo-yo, aspirin, escalator,* and *thermos*—all exclusively brand names at one time—eventually were declared generic terms that refer to product categories. As such, they can no longer be protected. To ensure that a brand name does not become a generic term, the firm should spell the name with a capital letter and use it as an adjective to modify the name of the general product class, as in Jell-O Brand Gelatin. An organization can deal directly with this problem by advertising that its brand is a trademark and should not be used generically. Firms also can use the registered trademark symbol® to indicate that the brand is trademarked.

brand equity marketing and financial value associated with a brand's strength in a market

12-5e **Branding Strategies**

The basic branding decision for any firm is how to brand its products. A producer may market its products under its own brands, private brands, or both. A retail store may carry only producer brands, its own brands, or both. Once either type of firm decides to brand, it chooses one of two branding strategies: individual branding or family branding.

Individual branding is the strategy in which a firm uses a different brand for each of its products. For example, Procter & Gamble uses individual branding for its line of bar soaps, which includes Ivory, Safeguard, and Olay. Individual branding offers two major advantages: a problem with one product will not affect the good name of the firm's other products and the different brands can be directed toward different market segments.

Family branding is the strategy in which a firm uses the same brand for all or most of its products. Sony, Dell, IBM, and Xerox use family branding for their product mixes. A major advantage of family branding is that successful promotion for any one item that carries the family brand can help all other products with the same brand name. In addition, a new product has a head start when its brand name is already known and accepted by customers. As an example, when Anheuser-Busch InBev introduced a new seltzer product to compete with White Claw, it called the line Bud Light Seltzer to capitalize on the name recognition of its Bud Light brand.[18]

12-5f **Brand Extensions**

A **brand extension** occurs when an organization uses one of its existing brands to brand a new product in a different product category. The French fashion house Louis Vuitton, for example, extended its brand when it opened an LV branded chocolate shop and café in a new glass tower in Ginza in Tokyo.[19] A brand extension should not be confused with a line extension. A *line extension* refers to using an existing brand on a new product in the same product category, such as a new flavor or new sizes. Pringles engages in line extension when releasing a new flavor, such as Nashville Hot Chicken flavor. Marketers must be careful not to extend a brand too many times or extend too far outside the original product category. Either action may weaken the brand.

individual branding the strategy in which a firm uses a different brand for each of its products

family branding the strategy in which a firm uses the same brand for all or most of its products

brand extension using an existing brand to brand a new product in a different product category

packaging all the activities involved in developing and providing a container with graphics for a product

12-5g **Packaging**

Packaging consists of all the activities involved in developing and providing a container with graphics for a product. The package is a vital part of the product. It can make the product more versatile, safer, or easier to use. Through its shape, size, appearance, and printed message, a package can influence purchasing decisions.

Packaging Functions Effective packaging is a combination of function and aesthetics. The basic function of packaging materials is to protect the product and maintain its functional form. Fluids such as milk, orange juice, and hair spray need packages that preserve and protect the product inside. Packaging should prevent damage that would affect the product's usefulness and increase costs. Because product tampering has become a problem for marketers of many types of goods, packaging techniques have been developed to counter this danger. Some packages are also designed to foil shoplifting.

VALUE
DESIGN
STRATEGY
TRUST
BRAND
LOGO
IDENTITY
ADVERTISING
MARKETING

STOATPHOTO/SHUTTERSTOCK.COM

Another function of packaging is to offer consumer convenience. For example, individual-serving boxes or plastic bags that contain liquids and do not require refrigeration appeal strongly to parents of small children and to young adults with active lifestyles. The size or shape of a package may relate to the product's storage, convenience of use, or replacement rate. Small, single-serving cans of vegetables, for instance, may prevent waste and make storage easier.

A third function of packaging is to promote a product by communicating its features, uses, benefits, and image. Sometimes a firm develops a reusable package to make its product more desirable. For example, CleanPath multi-surface cleaners employ Replenish technology which allows them to be sold as cleaner concentrate in pods that screw onto the bottom of a spray bottle. Consumers purchase the bottle once, add water, and the pod releases the correct amount of cleaner concentrate. The system saves on plastic and water waste and is cheaper than many competitors' products.[20]

Package Design Considerations Many factors must be weighed when developing packages. Obviously, one major consideration is cost. Expensive packaging can affect the final cost of a product.

Marketers must also decide whether to package the product in single or multiple units. Multiple-unit packaging can increase demand by increasing the amount of the product available at the point of consumption (in the home, for example). Multiple-unit packaging does not work for infrequently used products because buyers generally prefer not to have an excess supply or to store products for a long time. However, multiple-unit packaging can make storage and handling easier (as in the case of twelve-packs used for soft drinks). It can also facilitate special price offers, such as two-for-one sales. Multiple-unit packaging may encourage customers to try a product several times, but it may also backfire and deter them from trying the product if they cannot purchase just one.

Marketers should consider how much consistency is desirable among an organization's package designs. To promote an overall company image, a firm may decide that all packages must be similar or include a distinct design element. This approach, called *family packaging* is often used only for lines of products, as with Campbell's soups, Weight Watchers foods, and Planters nuts. The best policy is sometimes no consistency, especially if a firm's various products are unrelated or aimed at different target markets.

Packages also play an important promotional role. Through verbal and nonverbal symbols, the package informs potential buyers about the product's content, uses, features, advantages, and hazards. Businesses can create desirable images and associations by choosing particular colors, designs, shapes, and textures. Many cosmetics manufacturers, for example, design their packages to create impressions of richness, luxury, and exclusivity. The package performs another promotional function when it is designed to be safer or more convenient to use than competitors'.

Packaging also must meet the needs of intermediaries. Wholesalers and retailers consider whether a package is easy to transport, handle, and store. Resellers may refuse to carry certain products if their packages are too cumbersome.

Finally, firms must consider the issue of environmental responsibility when developing packages. Companies must balance consumers' desires for convenience against the need to preserve the environment. Reducing packaging will help with global waste problems because about one-half of all garbage consists of plastic packaging. As part of its long-term World Without Waste initiative, Coca-Cola introduced a new soft drink bottle made from 100 percent recycled plastic. It first rolled out the new 13.2-ounce bottles for Coke, Diet Coke, and Fanta in some areas, gradually expanding the geographic distribution and number of brands using the new recycled bottles. The new bottles are part of Coke's goal of making 100 percent of its packaging recyclable by 2025 and to use 50 percent recycled content by 2030.[21]

labeling the presentation of information on a product or its package

express warranty a written explanation of the producer's responsibilities in the event that a product is found to be defective or otherwise unsatisfactory

12-5h **Labeling**

Labeling is the presentation of information on a product or its package. The *label* is the part of a package that contains information, including the brand name and mark, the registered trademark symbol®, the package size and contents, product claims, directions for use and safety precautions, ingredients, the name and address of the manufacturer, and the Universal Product Code (UPC) symbol, which is used for automated checkout and inventory control. Labels are significant during the consumer buying decision process. Researchers have found that 60 percent of consumers will bypass a product when its label fails to present sufficient details, and 33 percent will reject a product if they don't like the design of the label.[22]

A number of federal regulations specify information that *must* be included in the labeling for certain products:

- Garments must be labeled with the name of the manufacturer, country of manufacture, fabric content, and cleaning instructions.
- Food labels must contain the most common term for ingredients and indicate whether the item contains common allergens.
- Any food product for which a nutritional claim is made must have nutrition labeling that follows a standard format.
- Food product labels must state the number of servings per container, the serving size, the number of calories per serving, the number of calories derived from fat, and the amounts of specific nutrients.
- Nonedible items such as shampoos and detergents must carry safety precautions and instructions for use.

Such regulations are aimed at protecting customers from misleading product claims and the improper (and thus unsafe) use of products. Food manufacturers are not allowed to make misleading health claims about their products.

Labels also may carry the details of written, or express, warranties. An **express warranty** is a written explanation of the producer's responsibilities in the event that a product is found to be defective or otherwise unsatisfactory.

NAQIUDDIN ZAKARIA/SHUTTERSTOCK.COM

Heinz turns the ketchup bottle on its head. The original design of the ketchup bottle made it difficult for customers to get the ketchup out. To solve this problem, Heinz put the cap on the bottom of the bottle and made the opening larger. In addition, Heinz made the bottle squeezable.

✓ Concept Check

- Describe the major types of brands.
- How do brands help customers in product selection? How do brands help companies introduce new products? Explain the three levels of brand loyalty.
- Define brand equity and describe the four major factors that contribute toward brand equity. What issues must be considered while choosing a brand name?
- What are the major functions of packaging?

12-6 Pricing Products

Learning Objective

12-6 Describe the economic basis of pricing and the means by which sellers can control prices and buyers' perceptions of prices.

A product is a set of attributes and benefits that has been designed to satisfy its market while earning a profit for its seller. Pricing is an integral part of this equation. Each product has a price at which consumers' desires and expectations are balanced with a firm's need to make a profit. We will now look more closely at how businesses go about determining a product's price.

12-6a **The Meaning and Use of Price**

The **price** of a product is the amount of money a seller is willing to accept in exchange for the product at a given time and under given circumstances. At times, the price results from negotiations between buyer and seller. In many business situations, however, the price is fixed by the seller. Suppose that a seller

price the amount of money a seller is willing to accept in exchange for a product at a given time and under given circumstances sets a price of $10 for a product. The seller is saying, "Anyone who wants this product can have it here and now in exchange for $10." Each interested buyer then makes a personal judgment regarding the product's utility, often in terms of a dollar value. People who feel that they will get at least $10 worth of want satisfaction (or value) from the product are likely to buy it. If they believe they can get more want satisfaction by spending $10 in some other way, they will not buy the product.

Price thus serves the function of *allocator.* First, it allocates goods and services among those who are willing and able to buy them. (As we noted in Chapter 1, the answer to the economic question "For whom to produce?" depends primarily on prices.) Second, price allocates financial resources (sales revenue) among producers according to how well they satisfy customers' needs. Third, price helps customers allocate their own financial resources among various want-satisfying products.

12-6b **Price and Non-Price Competition**

Before a product's price can be set, an organization must determine whether it will compete on the basis of price alone, or on a combination of factors. The choice influences pricing decisions as well as other marketing-mix variables.

Price competition occurs when a seller emphasizes a product's low price and sets a price that equals or beats competitors' prices. Planet Fitness, for example, experienced dramatic growth by offering $10/month gym memberships when other sport club memberships average $50 a month. Although Planet Fitness offers fewer amenities, its lower price is appealing to consumers who don't use most gym amenities—or simply forget to cancel.[23] To use this approach most effectively, a seller must have the flexibility to change prices often, rapidly, and aggressively in response to competitors' price changes. Price competition allows a marketer to set prices based on product demand or in response to changes in the firm's finances. Competitors can do likewise, however, which is a major drawback of price competition. If circumstances force a seller to raise prices, competing firms may be able to maintain their lower prices. The internet has made it more difficult than ever for sellers to compete on the basis of price, as consumers can quickly and easily conduct comparison-shopping online.

price competition an emphasis on setting a price equal to or lower than competitors' prices to gain sales or market share

non-price competition competition based on factors other than price

product differentiation the process of developing and promoting differences between one's product and all similar products

CHICKEN FRIED
FILL UP 5.00
FAMILY MEAL 14.99
3PC. BIG BOX MEAL $7.99
BIG BOX MEAL
20 FILL UP
HONEY MUSTARD BBQ
NASHVILLE HOT

ROBERT GREGORY GRIFFETH/SHUTTERSTOCK.COM

How low can you go? Price competition is fierce among fast-food restaurants. Value pricing has been used by some fast-food organizations for more than 20 years.

Non-price competition is competition based on factors other than price. It is used most effectively when a seller can make its product stand out through distinctive product quality, customer service, promotion, packaging, or other features. Buyers must be able to perceive these characteristics and consider them desirable. Once customers have chosen a brand for non-price reasons, they may not be as attracted to competing businesses and brands. In this way, a seller can build customer loyalty to its brand. A method of non-price competition, **product differentiation**, is the process of developing and promoting differences between one's product and all similar products. Consider the direct-to-consumer hair care company Prose, which creates customized shampoo and conditioner formulas for each customer, based on hair texture, local weather and water conditions, and what styling treatments they use. Although the products are offered at prices considerably higher than mass shampoos sold in stores, customers do not seem to mind paying more for products personalized just for them.[24]

Ethics and Social Responsibility

Companies Rebrand to Be More Sensitive

Over the years, critics have called for brands that use symbols that perpetuate racial stereotypes or are culturally insensitive to abandon them or remake them to convey more positive images. In recent years, social unrest and heightened calls for racial justice sparked a new national conversation about race in America. Many companies saw this as an opportunity to support people of color by ending brand imagery with insensitive connotations.

PepsiCo, the parent company for Quaker Oats, announced that it would rebrand its 130-year-old Aunt Jemima syrup brand, including the name and symbol. Although the Aunt Jemima brand mark had evolved over the decades, the company acknowledged in its statement that "Aunt Jemima's origins are based on a racial stereotype." The line of pancake mixes and syrups was reintroduced a year later as the Pearl Milling Company. Mars, Inc., which owns the Uncle Ben's brand of rice products, quickly followed with its own announcement, renaming the brand to Ben's Original.

The owners of other brands, including Cream of Wheat and Mrs. Butterworth, also pledged to examine their products and packaging for racially and culturally insensitive symbols. Land O'Lakes redesigned its packaging and dropped the Native American "butter maiden." Likewise, Dreyer's Grand Ice Cream announced that it would rebrand the century-old Eskimo Pie chocolate-covered ice cream and discontinue its Eskimo character symbols. Changing a brand, including its name and symbols, can be very expensive, but these companies recognize that rebranding positions them as being part of the solution to racial inequality.

Sources: Based on information in Maria Cramer, "After Aunt Jemima, Reviews Underway for Uncle Ben, Mrs. Butterworth and Cream of Wheat," *The New York Times*, June 17, 2020, https://www.nytimes.com/2020/06/17/business/aunt-jemima-mrs-butterworth-uncle-ben.html; Maria Cramer, "Maker of Eskimo Pie Ice Cream Will Retire 'Inappropriate' Name," *The New York Times*, June 20, 2020, www.nytimes.com/2020/06/20/business/dreyers-eskimo-pie-name-change.html; Ben Kesslen, "Aunt Jemima Brand to Change Name, Remove Image that Quaker Says Is 'Based on a Racial Stereotype,'" *NBCNews*, June 17, 2020, www.nbcnews.com/news/us-news/aunt-jemima-brand-will-change-name-remove-image-quaker-says-n1231260.

12-6c **Buyers' Perceptions of Price**

In setting prices, managers should consider the price sensitivity of the target market. Members of one market segment may be more influenced by price than members of another. Consumer price sensitivity can also vary between products. For example, buyers may be more sensitive to price when purchasing gasoline than when purchasing running shoes.

Buyers will tolerate a narrow range of prices for certain items and a wider range for others. Consider the varying prices of soft drinks—from 15 cents per ounce at the movies down to 1.5 cents per ounce on sale at the grocery store. Managers should be aware of consumers' price limits and the products to which they apply. The company also should take note of buyers' perceptions of a given product relative to competing products. A premium price may be appropriate if a product is considered superior to others in its category, or if the product has inspired strong brand loyalty. On the other hand, a lower price may be necessary if buyers have even a slightly negative product perception.

Sometimes buyers equate price and quality. Managers involved in pricing decisions should determine whether this outlook is widespread in the target market. If it is, a higher price may improve a product's image, making it more desirable.

✓ Concept Check

- What factors must be considered when pricing products?
- How does a change in price affect the demand and supply of a product?
- Differentiate price competition and non-price competition.
- Why is it important to consider the buyer's sensitivity to price when pricing products?

12-7 Pricing Objectives

Learning Objective

12-7 Specify the major pricing objectives used by businesses.

Before setting prices for a firm's products, marketers must establish pricing objectives that are aligned with organizational and marketing objectives. Of course,

What does a product's price communicate to you? How buyers perceive a product is often determined by its price. High prices communicate quality and status—which is why the makers of luxury goods such as Chanel handbags are often reluctant to sell them at a discount. The producers of these goods don't want to "cheapen" their brands for a quick sales boost because it could hurt the image of the brand.

ISTOCK.COM/ANDREAASTES

one objective of pricing is to make a profit, but this may not be a firm's primary objective. One or more of the following factors may be just as important.

12-7a Survival

A firm may have to price its products to survive—either as an organization or as a player in a particular market. This usually means that the company will cut its price to attract customers, even if it must operate at a loss for a while. Obviously, such a goal cannot be pursued on a long-term basis, for consistent losses would cause the business to fail.

12-7b Profit Maximization

Many businesses may state that their goal is to maximize profit, but this goal is impossible to define (and thus impossible to achieve). What, exactly, is the *maximum* profit? How does a company know when it has been reached? Firms that wish to set profit goals should express them as either specific dollar amounts, or percentage increases, over previous profits.

12-7c Target Return on Investment

The *return on investment* (ROI) is the amount earned as a result of a financial investment. Some businesses set an annual percentage ROI as a quantifiable means to gauge the success of their pricing goal.

12-7d Market-Share Goals

A firm's *market share* is its proportion of total industry sales. Some companies attempt, through pricing, to maintain or increase their market shares. Both U.S. cola giants, Coke and Pepsi, continually try to gain market share through aggressive pricing and other marketing efforts.

✓ Concept Check

- Explain the various types of pricing objectives.
- Which ones will usually result in a firm having lower prices?

12-7e Status-Quo Pricing

In pricing their products, some businesses are guided by a desire to maintain the status quo. This is especially true in industries that depend on price stability. If such a firm can maintain its profit or market share simply by matching the competition—charging about the same price as competitors for similar products—then it will do so.

12-8 Pricing Methods

Learning Objective

12-8 Compare the three major pricing methods that businesses employ.

Once a firm has developed its pricing objectives, it must select a pricing method to reach that goal. Two factors are important to every company engaged in setting prices. The first is recognition that the market, and not the firm's costs, ultimately determines the price at which a product will sell. The second is awareness that costs and expected sales can be used only to establish a *price floor,* the minimum price at which the firm can sell its product without incurring a loss. In this section, we look at three kinds of pricing methods: cost-based, demand-based, and competition-based pricing.

12-8a Cost-Based Pricing

Using the simplest method of pricing, *cost-based pricing*, the seller first determines the total cost of producing (or purchasing) one unit of the product. The seller then adds an amount to cover additional costs (such as insurance or interest) and profit. The amount that is added is called the **markup**. The total of the cost plus the markup is the product's selling price.

Marketers can calculate markup as a percentage of total costs. Suppose, for example, that the total cost of manufacturing and marketing 1,000 headsets is $100,000, or $100 per unit. If the manufacturer wants a markup that is 20 percent above costs, the selling price will be $100 plus 20 percent of $100, or $120 per unit.

Markup pricing is easy to apply and is used by many businesses (mostly retailers and wholesalers). However, it has two major flaws. The first is the difficulty of determining the best markup percentage. If the percentage is too high, the product may be overpriced for its market and too few units will be sold to cover the cost of producing and marketing it. If the markup percentage is too low, the seller forgoes profit it could have earned by assigning a higher price.

The second problem with markup pricing is that it separates pricing from other business functions. The product is priced *after* production quantities are determined, *after* costs are incurred, and almost without regard for the market or the marketing mix. To be most effective, the cost of various business functions should be integrated. *Each* should have an impact on all marketing decisions.

Cost-based pricing can also be calculated through breakeven analysis. For any product, the **breakeven quantity** is the number of units that must be sold for the total revenue (from all units sold) to equal the total cost (of all units sold). **Total revenue** is the total amount received from the sales of a product. We estimate projected total revenue as the selling price multiplied by the number of units expected to be sold.

The costs involved in operating a business can be broadly classified as either fixed or variable. A **fixed cost** is a cost incurred no matter how many units of a product are produced or sold. Rent, for example, is a fixed cost because it remains the same whether 1 or 1,000 units are produced. A **variable cost** is a cost that depends on the number of units produced. The cost of fabricating parts for a stereo receiver is a variable cost. The more units produced, the more efficient production will be and the per-unit cost of the parts will go down. The **total cost** of producing a certain number of units is the sum of the fixed costs and the variable costs attributed to those units.

If we assume a particular selling price, we can find the breakeven quantity either graphically or by using a formula. Figure 12-3 graphs the total revenue earned and the total cost incurred by the sale of various quantities of a hypothetical product. With fixed costs of $40,000, variable costs of $60 per unit, and a selling price of $120, the breakeven quantity is 667 units (represented in Figure 12-3 as the intersection of the total revenue and total cost curves). To find the breakeven quantity, first deduct the variable cost from the selling price to determine how much money the sale of

markup the amount a seller adds to the cost of a product to determine its basic selling price

breakeven quantity the number of units that must be sold for the total revenue (from all units sold) to equal the total cost (of all units sold)

total revenue the total amount received from the sales of a product

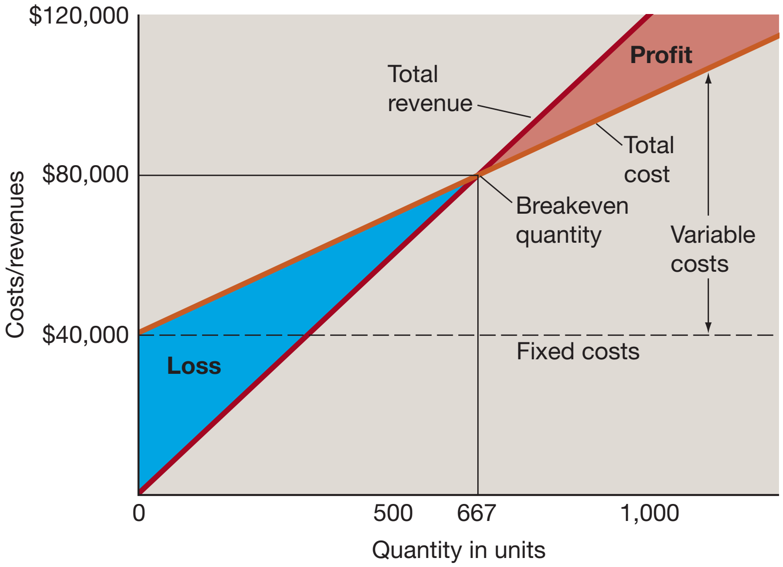
fixed cost a cost incurred no matter how many units of a product are produced or sold

variable cost a cost that depends on the number of units produced

total cost the sum of the fixed costs and the variable costs attributed to a product

Figure 12-3 **Breakeven Analysis**

Breakeven analysis answers the question: What is the lowest level of production and sales at which a company can break even on a particular product?



one unit contributes toward offsetting fixed costs. Divide that contribution into the total fixed costs to arrive at the breakeven quantity. If the firm sells more than 667 units at $120 each, it will earn a profit. If it sells fewer units, it will suffer a loss.

12-8b **Demand-Based Pricing**

Rather than basing the price of a product on its cost, companies sometimes use a pricing method based on the level of demand for the product: *demand-based pricing*. This method results in a higher price when product demand is strong and a lower price when demand is weak. To use this method, a marketer estimates the amount of a product that customers will demand at different prices and then chooses the price that should generate the highest total revenue. Obviously, the effectiveness of this method depends on the firm's ability to estimate demand accurately.

A company may favor a demand-based pricing method called *price differentiation* if it wants to use more than one price in the marketing of a specific product. Price differentiation can be based on such considerations as time of the purchase, type of customer, or type of distribution channel. The use of so-called *dynamic pricing*—which raises prices during periods of high demand—is growing, especially for services such as car ride-hailing apps like Uber and Lyft as well as restaurants looking for a more even flow of customers throughout the day. For instance, all tickets for Los Angeles Dodgers' baseball games are sold using dynamic pricing. Ticket prices are adjusted based on real-time market conditions that include seat location, the popularity of time and day, as well as whether there are special promotions like bobblehead giveaways.[25] For price differentiation to work, the company must be able to segment a

ISTOCK.COM/SOLSTOCK

Did you pay twice as much for your plane ticket as the person sitting next to you? Airlines use demand-based pricing. The sophisticated software the companies use constantly re-prices seats based on historical data, as well as how many customers are purchasing tickets at any given time on a specific flight.

market on the basis of different strengths of demand. The company must then be able to keep the segments separate enough so that those who buy at lower prices cannot sell to buyers in segments that are charged a higher price. This isolation can be accomplished, for example, by selling to geographically separated segments. However, the internet has made price differentiation for products more difficult.

Compared with cost-based pricing, demand-based pricing places a firm in a better position to attain higher profit levels, assuming that buyers value the product at levels sufficiently above the product's cost. To use demand-based pricing, however, management must be able to estimate demand at different price levels, which may be difficult to assess accurately.

12-8c **Competition-Based Pricing**

In using *competition-based pricing*, an organization considers costs and revenue secondary to competitors' prices. The importance of this method increases if competing products are similar and the organization is serving markets in which price is the crucial variable of the marketing strategy. A firm that uses competition-based pricing may choose to sell below competitors' prices, slightly above competitors' prices, or at the same level. The price that your bookstore paid to the publishing company of this text was determined using competition-based pricing. Competition-based pricing can help to attain a pricing objective to increase sales or market share. Competition-based pricing may also be combined with other cost approaches to arrive at a profitable level.

✓ Concept Check

- List and explain the three kinds of pricing methods.
- Give an advantage and a disadvantage for each method.

12-9 Pricing Strategies

Learning Objective

12-9 Explain the different strategies available to companies for setting prices.

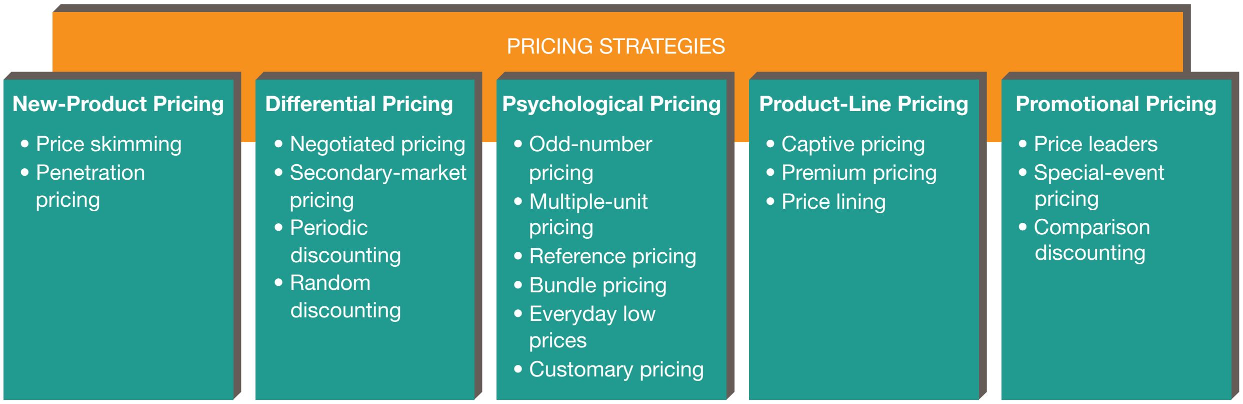
A *pricing strategy* is a course of action designed to achieve pricing objectives. The extent to which a business uses any of the following strategies depends on its pricing and marketing objectives, the markets for its products, the degree of product differentiation, the product's life-cycle stage, and other factors. Figure 12-4 is a list of the major types of pricing strategies. We discuss these strategies in the remainder of this section.

12-9a **New-Product Pricing**

The two primary types of new-product pricing strategies are price skimming and penetration pricing. An organization can use either one, or even both, over a period of time.

Figure 12-4 **Types of Pricing Strategies**

Companies have a variety of pricing strategies available to them.



PRICING STRATEGIES

New-Product Pricing
- Price skimming
- Penetration pricing

Differential Pricing
- Negotiated pricing
- Secondary-market pricing
- Periodic discounting
- Random discounting

Psychological Pricing
- Odd-number pricing
- Multiple-unit pricing
- Reference pricing
- Bundle pricing
- Everyday low prices
- Customary pricing

Product-Line Pricing
- Captive pricing
- Premium pricing
- Price lining

Promotional Pricing
- Price leaders
- Special-event pricing
- Comparison discounting

Price Skimming Some consumers are willing to pay a high price for an innovative product, either because of its novelty or because of the prestige or status that ownership confers. **Price skimming** is the strategy of charging the highest possible price for a product during the introduction stage of its life cycle. This strategy helps to recover the high costs of R&D quickly. In addition, a skimming policy may hold down demand for the product, which is helpful if the firm's production capacity is limited during the introduction stage. A danger is that a price-skimming strategy may make the product appear more lucrative than it actually is to potential competitors, encouraging more competitors to enter the market.

Penetration Pricing At the opposite extreme, **penetration pricing** is the strategy of setting a low price for a new product to build market share quickly. The seller hopes that building a large market share will discourage competitors from entering the market. If the low price stimulates sales, the business may also be able to order longer production runs, which usually results in lower production costs per unit. A disadvantage of penetration pricing is that it places a firm in a less flexible position on pricing. It is more difficult to raise prices significantly than it is to lower them.

12-9b Differential Pricing

An important issue in pricing decisions is whether to use a single price or different prices for the same product. *Differential pricing* means charging different prices to different buyers for the same quality and quantity of product. For example, many theaters offer discounted tickets for daytime matinee performances, and airlines have different pricing tiers for airline seats depending on whether customers paid extra to board early or other perks. For differential pricing to be effective, the market must consist of multiple segments with different price sensitivities. When this method is employed, caution should be used to avoid confusing or antagonizing customers. Differential pricing can take several forms, including negotiated pricing, secondary-market pricing, periodic discounting, and random discounting.

Negotiated Pricing **Negotiated pricing** occurs when the final price is established through bargaining between the seller and the customer. Negotiated pricing occurs at all levels of distribution and is common in a variety of industries. Even when there is a predetermined stated price or a price list, manufacturers, wholesalers, and retailers may negotiate to establish the final sales price. Consumers commonly negotiate prices for houses, cars, and used equipment.

Secondary-Market Pricing **Secondary-market pricing** means setting one price for the primary target market and a different price for another market. The price charged in the secondary market is often, but not always, lower. Examples of secondary markets include a geographically isolated domestic market, a market in a foreign country, and a segment willing to purchase a product during off-peak times (such as "early bird" dinners at restaurants and matinee showings at movie theaters).

Periodic Discounting **Periodic discounting** is the temporary reduction of prices on a patterned or systematic basis. For example, many retailers have annual holiday sales, and apparel stores have seasonal sales. From the marketer's point of view, a problem with periodic discounting is that customers can predict when the reductions will occur and may delay their purchases until they can take advantage of the lower prices.

Random Discounting To alleviate the problem of customers holding off on purchases until a discount period, some organizations employ **random discounting**. That is, they reduce their prices temporarily on a nonsystematic basis. When price

price skimming the strategy of charging the highest possible price for a product during the introduction stage of its life cycle

penetration pricing the strategy of setting a low price for a new product to build market share quickly

negotiated pricing establishing a final price through bargaining

secondary-market pricing setting one price for the primary target market and a different price for another market

periodic discounting temporary reduction of prices on a patterned or systematic basis

random discounting temporary reduction of prices on an unsystematic basis reductions of a product occur randomly, current users of that brand are not able to predict when reductions will occur. They therefore will not delay their purchases in anticipation of purchasing the product at a lower price. Marketers also use random discounting to attract new customers.

12-9c Psychological Pricing

Psychological pricing strategies encourage purchases based on emotional responses rather than on economically rational ones. These strategies are used primarily for consumer products rather than business products.

Odd-Number Pricing Many retailers believe that consumers respond more positively to odd-number prices such as \$4.99 than to whole-dollar prices such as \$5. **Odd-number pricing** is the strategy of setting prices using odd numbers that are slightly below whole-dollar amounts. Nine and five are the most popular ending figures for odd-number prices.

Multiple-Unit Pricing Many retailers (supermarkets in particular) practice **multiple-unit pricing**, setting a single price for two or more units, such as two cans for 99 cents, rather than 50 cents per can. Especially for frequently purchased products, this strategy can increase the amount of an item that is sold. Customers who see the single price and who expect eventually to use more than one unit of the product will purchase multiple units to save money.

Reference Pricing **Reference pricing** means pricing a product at a moderate level and positioning it next to a more expensive model or brand in the hope that the customer will use the higher price as a reference price (i.e., a comparison price). Because of the comparison, the customer is expected to view the moderate price favorably.

Bundle Pricing **Bundle pricing** is the packaging together of two or more products, usually of a complementary nature, to be sold for a single price. To be attractive to customers, the single price usually is considerably less than the sum of the prices of the individual products. Because the products are complementary, such as shampoo and conditioner, the customer will also find convenience value from purchasing them together. The firm may find bundling to be a valuable strategy because, by bundling slow-moving products with more popular ones, an organization can stimulate sales and increase revenues. Selling products as a package rather than individually also may result in cost savings for the organization. It is common for telecommunications providers to sell service bundles of cable, internet, and phone service for one price.

Everyday Low Prices (EDLPs) To reduce or eliminate frequent short-term price reductions, some organizations use an approach referred to as **everyday low prices (EDLPs)**. When EDLPs are used, a marketer sets a low price for its products on a consistent basis, rather than setting high prices and frequently discounting them. EDLPs, though not deeply discounted, are set far enough below competitors' prices to make customers feel confident that they are receiving a good deal. EDLPs are employed by retailers such as Walmart and by manufacturers such as Procter & Gamble. A company that uses EDLPs benefits from reduced promotional costs, reduced losses from frequent markdowns, and more stability in sales. However, customers may not trust the EDLP and assume the deal is merely a marketing gimmick.

Customary Pricing In **customary pricing**, certain goods are priced primarily on the basis of tradition. It is not as common as it once was, but examples of customary, or traditional, prices are those set for candy bars and chewing gum.

odd-number pricing the strategy of setting prices using odd numbers that are slightly below whole-dollar amounts

multiple-unit pricing the strategy of setting a single price for two or more units

reference pricing pricing a product at a moderate level and positioning it next to a more expensive model or brand

bundle pricing packaging together two or more complementary products and selling them for a single price

everyday low prices (EDLPs) setting a low price for products on a consistent basis

customary pricing pricing on the basis of tradition

12-9d **Product-Line Pricing**

Rather than considering products on an item-by-item basis when determining pricing strategies, some marketers employ product-line pricing. *Product-line pricing* means establishing and adjusting the prices of multiple products within a product line. Product-line pricing can provide marketers with flexibility in price setting. For example, marketers can set prices high so that one product is highly profitable, whereas another has a low price to increase market share.

When marketers employ product-line pricing, they have several strategies from which to choose. These include captive pricing, premium pricing, and price lining.

Captive Pricing When **captive pricing** is used, the basic product in a product line is priced low, but the price on the items required to operate or enhance it are higher. Two common examples of captive pricing are razor blades and printer ink. The razor handle and the printer are generally priced quite low, but the razor blades and the printer ink replacement cartridges are usually very expensive.

Premium Pricing **Premium pricing** occurs when the highest-quality product or the most-versatile version of similar products in a product line is assigned the highest price. Other products in the line are priced to appeal to more price-sensitive shoppers, or to those seeking product-specific features. Marketers that employ premium pricing often realize a significant portion of profits from the premium-priced products. Examples of product categories in which premium pricing is common are small kitchen appliances, beer, ice cream, and television cable service.

Price Lining **Price lining** is the strategy of selling goods only at certain predetermined prices that reflect definite price breaks. For example, a shop may sell men's ties only at $22 and $37. This strategy is used in clothing and accessory stores. It eliminates minor price differences from the buying decision—both for customers and for managers who buy merchandise to sell in these stores.

12-9e **Promotional Pricing**

Price, as an ingredient in the marketing mix, often is coordinated with promotions. The two variables sometimes are so interrelated that the pricing policy is promotion-oriented. Examples of promotional pricing include price leaders, special-event pricing, and comparison discounting.

Price Leaders Sometimes, a firm prices a few products below the usual markup, near cost, or below cost, which results in **price leaders**. This type of pricing is used most often in supermarkets and restaurants to attract customers by giving them especially low prices on a few items. Management hopes that customers will purchase regularly priced items as well, which will offset the reduced revenues from the price leaders.

Special-Event Pricing To increase sales volume, many organizations coordinate price with advertising or sales promotions for seasonal or special occasions. **Special-event pricing** involves advertised sales or price cutting linked to a holiday, season, or event. If the pricing objective is survival, then special sales events may be designed to generate the necessary operating capital.

Comparison Discounting **Comparison discounting** sets the price of a product at a specific level and compares it with a higher price. The higher price may be the product's previous price, the price of a competing brand, the product's price at another retail outlet, or a manufacturer's suggested retail price. Comparison discounting can significantly influence customers' decisions. Because this pricing

captive pricing pricing the basic product in a product line low, but pricing related items at a higher level

premium pricing pricing the highest-quality or most-versatile products higher than other models in the product line

price lining the strategy of selling goods only at certain predetermined prices that reflect definite price breaks

price leaders products priced below the usual markup, near cost, or below cost

special-event pricing advertised sales or price cutting linked to a holiday, season, or event

comparison discounting setting a price at a specific level and comparing it with a higher price strategy can lead to deceptive pricing practices, the Federal Trade Commission (FTC) has established guidelines for comparison discounting. If the higher price against which the comparison is made is the price formerly charged for the product, sellers must have made the previous price available to customers for a reasonable period of time. If sellers present the higher price as the one charged by other retailers in the same trade area, they must be able to demonstrate the veracity of the claim. When they present the higher price as the manufacturer's suggested retail price, then the higher price must be similar to the price at which a reasonable proportion of the product was sold.

✓ Concept Check

- Identify the five categories of pricing strategies.
- Describe two specific pricing strategies in each category.

12-10 Pricing Business Products

Learning Objective

12-10 Recognize three major types of pricing associated with business products.

Many of the pricing issues discussed thus far in this chapter deal with pricing in general. However, setting prices for business products is different from setting prices for consumer products because of factors such as the size of purchases, transportation considerations, and geographic issues. We examine three types of pricing associated with business products: geographic pricing, transfer pricing, and discounting.

12-10a Geographic Pricing

Geographic pricing strategies deal with delivery costs. The pricing strategy that requires the buyer to pay the delivery costs is called *FOB origin pricing*. This stands for "free on board at the point of origin," which means that the price does not include freight charges. Thus, the buyer must pay the transportation costs from the seller's warehouse to the buyer's place of business. *FOB destination* indicates that the price does include freight charges, and thus the seller pays these charges.

12-10b Transfer Pricing

When one unit within an organization sells a product to another unit, **transfer pricing** occurs. The price is determined by calculating the cost of the product. A transfer price can vary depending on the types of costs included in the calculations. The choice of the costs to include depends on the company's management strategy and the nature of the units' interactions. An organization also must ensure that transfer pricing is fair to all units involved in the purchases.

transfer pricing prices charged in sales between an organization's units

discount a deduction from the price of an item

12-10c Discounting

A **discount** is a deduction from an item's price. Producers and sellers may offer a wide variety of discounts to their customers, including trade, quantity, cash, and seasonal discounts and allowances. *Trade discounts* are reductions taken off the list prices that are offered to marketing intermediaries, or middlemen. *Quantity discounts* are discounts given to customers who buy in large quantities, which makes the seller's per-unit selling cost lower for larger purchases. *Cash discounts* are concessions offered for prompt payment. A seller may offer a discount of "2/10, net 30," meaning that the buyer receives a 2 percent discount if full payment occurs within ten days; otherwise, payment in full is due within 30 days. A *seasonal discount* is a price reduction to buyers that purchase out of season. This discount encourages off-season sales and ensures steady production throughout the year. An *allowance* is a reduction in price to achieve a desired goal. Trade-in allowances, for example, are price reductions granted for turning in used equipment when purchasing new equipment. Table 12-3 describes some of the reasons for using these discounting techniques and some examples.

✓ Concept Check

- Describe the three types of pricing associated with business products.
- Differentiate between FOB origin and FOB destination pricing.
- Explain the five types of discounts for business products.

Table 12-3 Discounts Used for Business Markets

Type	Reasons for Use	Examples
Trade (functional)	To attract and retain effective resellers by compensating them for performing certain functions, such as transportation, warehousing, selling, and providing credit.	A college bookstore pays about one-third less for a new textbook than the retail price a student pays.
Quantity	To encourage customers to buy large quantities when making purchases and, in the case of cumulative discounts, to encourage customer loyalty.	Large department store chains purchase some women's apparel at lower prices than do individually owned specialty stores.
Cash	To reduce expenses associated with accounts receivable and collection by encouraging prompt payment of accounts.	Numerous companies serving business markets allow a 2 percent discount if an account is paid within ten days.
Seasonal	To allow a marketer to use resources more efficiently by stimulating sales during off-peak periods.	Florida hotels provide companies, holding national and regional sales meetings, with deeply discounted accommodations during the summer months.
Allowance	In the case of a trade-in allowance, to assist the buyer in making the purchase and potentially earn a profit on the resale of used equipment. In the case of a promotional allowance, to ensure that dealers participate in advertising and sales support programs.	A farm equipment dealer takes a farmer's used tractor as a trade-in on a new one. Nabisco pays a promotional allowance to a supermarket for setting up and maintaining a large end-of-aisle display for a two-week period.

Summary

12-1 Explain what a product is and how products are classified.

A product is everything one receives in an exchange, including all attributes and expected benefits. The product may be a manufactured item, a service, an idea, or a combination.

Products are classified according to their ultimate use. Classification affects a product's distribution, promotion, and pricing. Consumer goods, which include convenience, shopping, specialty, and unsought products, are purchased to satisfy personal and family needs. Business products are purchased for resale, in making other products, or for use in a firm's operations. Business products can be classified as raw materials, major equipment, accessory equipment, component parts, process materials, supplies, and services.

12-2 Describe the product life cycle and how it leads to new-product development.

Every product moves through a series of four stages— introduction, growth, maturity, and decline—which together form the product life cycle. As the product progresses through these stages, its sales and profitability increase, peak, and decline. Marketers keep track of the life-cycle stage of products in order to determine appropriate strategies and to estimate when a new product should be introduced to replace a declining one.

12-3 Define *product line* and *product mix* and distinguish between the two.

A product line is a group of similar products marketed by a firm. They are related to each other in the way they are produced, marketed, and consumed. The firm's product mix includes all the products it offers for sale. The width of a mix is the number of product lines it contains. The depth of the mix is the average number of individual products within each line.

12-4 Identify the methods available for managing a product mix.

Customer satisfaction and organizational objectives require marketers to develop, adjust, and maintain an effective product mix. Marketers may improve a product mix by changing existing products, deleting products, and developing new products. A product mix can be changed by deriving additional products from existing ones through product modifications and by line extensions. Deleting a weak and unprofitable product that costs a company resources may be necessary to modify other products or develop new ones. Developing new products is expensive and potentially risky. New products are developed through a series of seven steps. The first step, idea generation, involves developing a pool of product ideas. Screening, the second step, removes from consideration those product ideas that do not match organizational goals or resources. Concept testing, the third step, is a phase in which a sample of potential buyers is exposed to a proposed product through a written or oral description in order to determine their initial reactions and buying intentions. The fourth step, business analysis, generates information about potential sales, costs, and profits. During the technical development step, the product idea is transformed into mock-ups and prototypes to determine if product production is technically feasible and can be produced at reasonable costs. Test marketing is an actual launch of the product in selected cities chosen for their representativeness of target markets. Finally, during commercialization, plans for full-scale production and marketing are refined and implemented. Most product failures result from inadequate product planning and development.

12-5 Examine the uses and importance of branding, packaging, and labeling.

A brand is a name, term, symbol, design, or any combination of these that identifies a seller's products as distinct from those of other sellers. Brands can be identified by a brand name, brand mark, and trademark, and they can be classified as manufacturer brands, store brands, or generic brands. Buyers and sellers both benefit from branding, and branding can foster loyalty and confer value. Brands should be chosen carefully to set them apart and protected to preserve their exclusive use. A firm can choose between two branding strategies—individual or family branding—which are used to associate (or *not* associate) particular products with existing products, producers, or intermediaries. Brands can also be extended to new product categories.

Packaging protects goods, increases consumer convenience, and enhances marketing efforts by communicating product features, uses, benefits, and image. Marketers must consider factors such as cost, consistency, promotional use, and sustainability when designing packaging.

Labeling provides customers with product information, some of which is required by law.

12-6 Describe the economic basis of pricing and the means by which sellers can control prices and buyers' perceptions of prices.

The price of a product is the amount of money a seller is willing to accept in exchange for the product at a given time and under given circumstances. Price thus serves the function of allocating goods and services among those who are willing and able to buy them, financial resources among producers according to how well they satisfy customers' needs, and customers' own financial resources among products.

Price competition occurs when a seller emphasizes a product's low price and sets a price that equals or beats competitors' prices. To use this approach most effectively, a seller must have the flexibility to change prices often. Nonprice competition is based on factors other than price. It is used most effectively when a seller can make its product stand out from the competition by differentiating product quality, customer service, promotion, packaging, or other features. Buyers' perceptions of prices are affected by the importance of the product to them, the range of prices they consider acceptable, their perceptions of competing products, and their association of quality with price.

12-7 Specify the major pricing objectives used by businesses.

Objectives of pricing include survival, profit maximization, target return on investment, achieving market goals, and maintaining the status quo. Firms sometimes have to price products to survive, which usually requires cutting prices to attract customers. The return on investment (ROI) is the amount earned as a result of the investment in developing and marketing the product. Some businesses set an annual percentage ROI as the pricing goal. Other firms use pricing to maintain or increase their market share. In industries in which price stability is important, companies often price their products by charging about the same as competitors.

12-8 Compare the three major pricing methods that businesses employ.

The three major pricing methods are cost-based pricing, demand-based pricing, and competition-based pricing. When cost-based pricing is employed, a proportion of the cost is added to the total cost to determine the selling price. It can be added as an amount called a markup or calculated through breakeven analysis by understanding the costs involved. When demand-based pricing is used, the price will be higher when demand is higher, and the price will be lower when demand is lower. A firm that uses competition-based pricing may choose to price below competitors' prices, at the same level as competitors' prices, or slightly above competitors' prices.

12-9 Explain the different strategies available to companies for setting prices.

Pricing strategies fall into five categories: new-product pricing, differential pricing, psychological pricing, product-line pricing, and promotional pricing. Price skimming and penetration pricing are two strategies used for pricing new products. Differential pricing can be accomplished through negotiated pricing, secondary-market pricing, periodic discounting, and random discounting. Types of psychological pricing strategies are odd-number pricing, multiple-unit pricing, reference pricing, bundle pricing, everyday low prices, and customary pricing. Product-line pricing can be achieved through captive pricing, premium pricing, and price lining. The major types of promotional pricing are price-leader pricing, special-event pricing, and comparison discounting.

12-10 Recognize three major types of pricing associated with business products.

Setting prices for business products is different from setting prices for consumer products because of several factors, including the size of purchases, transportation considerations, and geographic issues. The three types of pricing associated with business products are geographic pricing, transfer pricing, and discounting.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

product (330)
consumer product (331)
business product (331)
convenience product (331)
shopping product (331)
specialty product (331)
unsought product (331)
raw material (332)
major equipment (332)
accessory equipment (332)
component part (332)
process material (332)
supply (332)
business service (332)
product life cycle (333)
product line (336)
product mix (336)
product modification (337)
line extension (337)
product deletion (338)
brand (342)
brand name (342)
brand mark (342)
trademark (342)
trade name (342)
manufacturer (or producer) brand (342)
store (or private) brand (342)
generic product (or generic brand) (343)
brand loyalty (343)
brand equity (344)
individual branding (345)
family branding (345)
brand extension (345)
packaging (345)
labeling (347)
express warranty (347)
price (347)
price competition (348)
non-price competition (348)
product differentiation (348)
markup (351)
breakeven quantity (351)
total revenue (351)
fixed cost (351)
variable cost (351)
total cost (351)
price skimming (354)
penetration pricing (354)
negotiated pricing (354)
secondary-market pricing (354)
periodic discounting (354)
random discounting (354)
odd-number pricing (355)
multiple-unit pricing (355)
reference pricing (355)
bundle pricing (355)
everyday low prices (EDLPs) (355)
customary pricing (355)
captive pricing (356)
premium pricing (356)
price lining (356)
price leaders (356)
special-event pricing (356)
comparison discounting (356)
transfer pricing (357)
discount (357)

Discussion Questions

1. What major factor determines whether a product is a consumer or a business product?
2. What are the four stages of the product life cycle? How can a firm determine which stage a particular product is in?
3. Under what conditions does product modification work best?
4. Some companies do not delete products until they become financially threatening. What problems may result from this practice?
5. Why should businesses introduce new products?
6. What is the difference between manufacturer brands and store brands? Between family branding and individual branding?
7. What is the difference between a line extension and a brand extension?
8. For what purposes is labeling used?
9. Compare and contrast the characteristics of price and non-price competition. Under what conditions would a firm be most likely to use non-price competition?
10. How might buyers' perceptions of price influence pricing decisions?
11. What are the five major categories of pricing strategies? Give at least two examples of specific strategies that fall into each category.
12. Identify and describe the main types of discounts that are used in the pricing of business products.
13. Under what conditions would a business most likely decide to employ one of the differential pricing strategies?
14. For what types of products are psychological pricing strategies most likely to be used?

Case 12

Shinola Is One to Watch

Shinola Watch Company is a luxury design brand that sells timepieces, leather goods, jewelry, and more. The Shinola brand dates back to 1877 when it was a shoe polish company in Rochester, New York. It operated for nearly 100 years before going out of business in 1960. Tom Kartsotis, the founder of Fossil Group, a multi-billion-dollar watch company, decided to create Shinola Watch Company in 2011 with investment group Bedrock Manufacturing. Kartsotis's goal was to create a high-quality American watch brand that could compete with Swiss watchmakers at a lower price point. The company introduced its first watch in 2013, producing 2,500 watches and selling them for $550 each. The watches sold out in two weeks. Shinola was creating timepieces in a way that hadn't been done in the United States since the 1960s.

The company's watch and leather factory is located in Detroit, Michigan. Inside, artisans assemble Shinola's timepieces and other products by hand. The company employs more than 500 people and is committed to delivering the highest quality products. Shinola creates opportunities for its employees with extensive training. Employees meticulously assemble watches by hand. The Shinola team assembles between 500 and 700 watches per day and cuts and sews up to 550 leather watch straps per day. From start to finish, each watch may touch the hands of more than 30 people.

A commitment to quality is at the core of Shinola Watch Company. For example, its watches and leather straps that are produced in-house are done so using labor-intensive methods and custom Italian machinery. For its other leather goods, Shinola partnered with hand-selected manufacturers to scale production. The watchmaker creates products that last and stands behind its craftsmanship with industry-leading guarantees. Shinola offers a limited lifetime warranty of its core watch styles and a best-in-class three-year-limited warranty on its Detrola Watch Collection.

Shinola has promoted itself as an American-made brand and a supporter of Detroit. Its watches are even labeled "Detroit." However, the company's American pride was called into question when the Federal Trade Commission (FTC) discovered that some of its watches were made almost entirely out of foreign parts. The FTC is charged with protecting consumers from deceptive advertising. In response, Shinola changed its labeling to read "built in Detroit" and "Swiss & imported parts."

The company has also been criticized for using Detroit as a marketing tool and exploiting the city's hardships to sell watches. Supporters of the company say this is not the case and highlight the fact that Shinola has supported the local economy by adding jobs and helping to make Detroit a cleaner and safer place. However, recently, the company laid off several employees and announced plans to outsource leather design and product development to keep costs down, remain competitive in the watch industry, and clear a path to profitable growth.

Shinola's customers are its top supporters. Notable customers include former Michigan governor Rick Snyder, Oscar-winning director Peter Farrelly, and former presidents Bill Clinton and Barack Obama. Today, Shinola continues to match its high-quality timepieces along with a variety of other luxury goods. The company operates boutiques in 14 cities in the United States, Canada, and the United Kingdom along with its own boutique hotel in downtown Detroit.[26]

Questions

1. How does Shinola Watch Company back up its commitment to quality?
2. What measures has Shinola taken to keep its prices lower than Swiss competitors?
3. Why do you think Shinola advertises itself as being an American brand?

Building Skills for Career Success

1. Social Media Exercise

Casper is a direct-to-consumer company that makes and sells memory foam mattresses through its website. Unlike many mattress retailers, Casper sells just four mattresses, though in all available sizes, plus one for dogs. It prices the mattresses below that of most brick-and-mortar mattress stores and offers a 100-day trial period to help nudge customers into clicking the "buy" button. The young company doesn't spend a lot on advertising, so building brand recognition and preference is key to achieving sales. One way the firm does so is through its @Casper Twitter account, which regularly tweets in the persona of a Casper mattress, especially late at night when those having trouble sleeping are likely to be perusing social media. The tweets are often amusing and timely one-liners about sleep, though followers are likely to find humorous memes, GIFs, and videos, as well as links to information about sleep and insomnia in the timeline.

1. Go to Twitter.com and search for @Casper and look through recent tweets in the account's timeline. How is Casper using humor and pop culture to build brand loyalty?
2. What is the role of humor in Casper's tweets? In what ways does humor move customers closer to making a purchase, if at all?

2. Building Team Skills

In his book, *The Post-Industrial Society*, Peter Drucker wrote:

> *Society, community, and family are all conserving institutions. They try to maintain stability and to prevent, or at least slow down, change. But the organization of the post-capitalist society of organizations is a destabilizer. Because its function is to put knowledge to work—on tools, processes, and products; on work; on knowledge itself—it must be organized for constant change. It must be organized for innovation.*

New product development is important in this process of systematically abandoning the past and building a future. Current customers can be sources of ideas for new products and services and ways of improving existing ones.

Assignment

1. Working in teams of five to seven, brainstorm ideas for new products (goods, services, or ideas) for your college.
2. Construct questions to ask currently enrolled students (your customers). Sample questions might include:
   a. Why did you choose this college?
   b. How can this college be improved?
   c. What products do you wish were available?
3. Conduct the survey and review the results.
4. Prepare a list of improvements and/or new products for your college.

3. Researching Different Careers

Marketing involves creating, delivering, and communicating about products that have value for customers. Within this exciting and evolving field are many jobs that may offer a lucrative and rewarding career path.

Assignment

1. Research marketing careers. You may find sites such as flexjobs.com, indeed.com, thebalancecareers.com, and https://www.bls.gov/ooh/helpful.
   a. Identify three jobs within the marketing field that interest you.
   b. What type of work do each of these jobs involve?
   c. What are the potential earnings of these jobs?
   d. What is the long-term outlook for these jobs?
   e. How can you qualify for each of them?
2. Prepare a report of your findings.

Chapter

13

ISTOCK.COM/SCHROPTSCHOP

Distributing and Promoting Products

Learning Objectives

Once you complete this chapter, you will be able to:

13-1 Examine the various distribution channels and market coverage of products.

13-2 Explain how supply chain management facilitates partnering among channel members.

13-3 Describe the types of wholesalers and the services they provide.

13-4 Distinguish among the major types of retailers and shopping centers.

13-5 Identify the five most important logistics activities.

13-6 Define integrated marketing communications.

13-7 List the basic elements of the promotion mix.

13-8 Examine advertising, including types of advertising, the advertising campaign, and social and legal considerations.

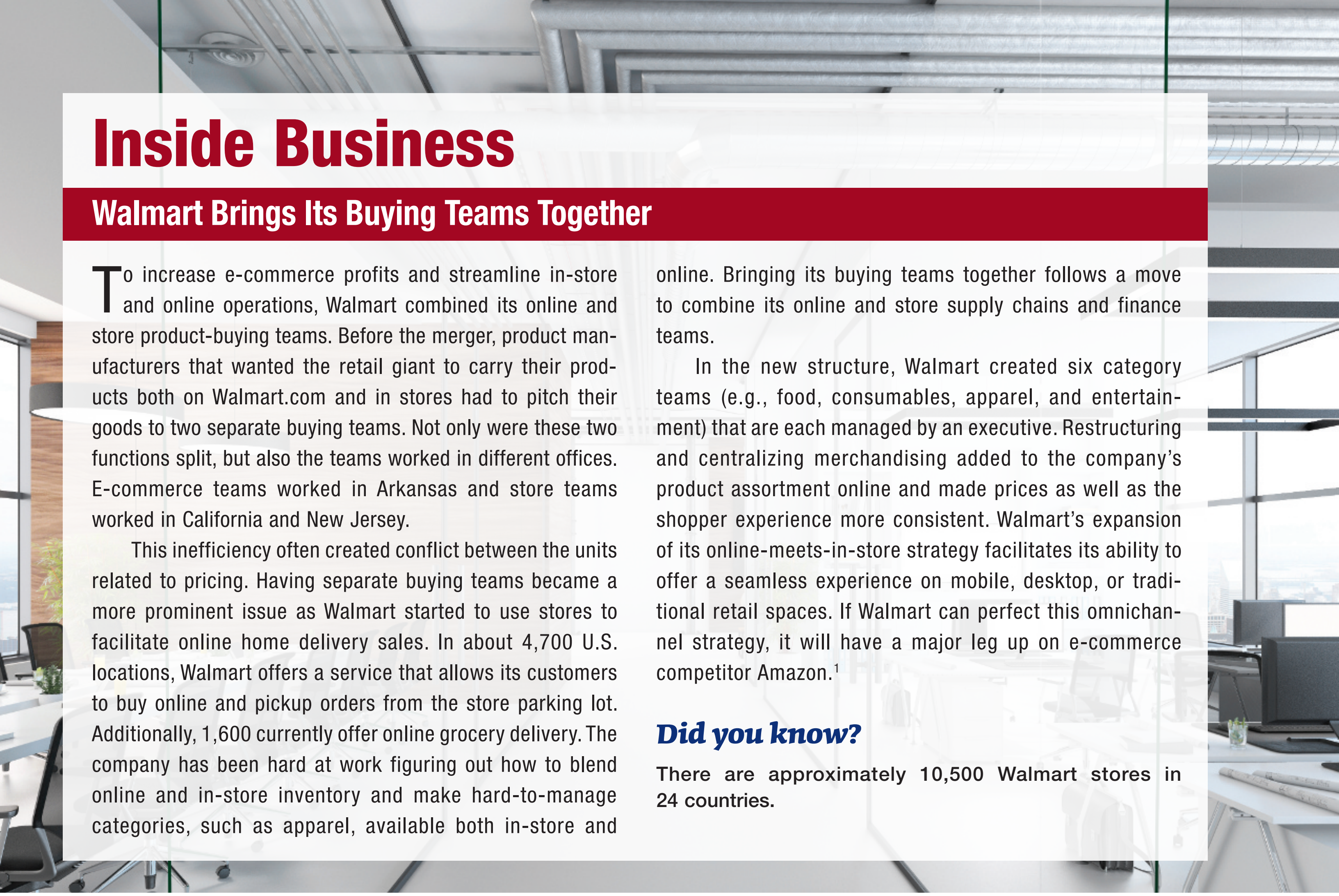
13-9 Explore personal selling, including the types of salespersons, the personal-selling process, and major sales management tasks.

13-10 Identify sales promotion objectives and methods.

13-11 Describe the types and uses of public relations.

Why Should You Care?

Not only is it important to create and maintain a mix of products that satisfies customers but also to make these products available at the *right place* and *time* and to communicate with customers effectively.



Inside Business

Walmart Brings Its Buying Teams Together

To increase e-commerce profits and streamline in-store and online operations, Walmart combined its online and store product-buying teams. Before the merger, product manufacturers that wanted the retail giant to carry their products both on Walmart.com and in stores had to pitch their goods to two separate buying teams. Not only were these two functions split, but also the teams worked in different offices. E-commerce teams worked in Arkansas and store teams worked in California and New Jersey.

This inefficiency often created conflict between the units related to pricing. Having separate buying teams became a more prominent issue as Walmart started to use stores to facilitate online home delivery sales. In about 4,700 U.S. locations, Walmart offers a service that allows its customers to buy online and pickup orders from the store parking lot. Additionally, 1,600 currently offer online grocery delivery. The company has been hard at work figuring out how to blend online and in-store inventory and make hard-to-manage categories, such as apparel, available both in-store and online. Bringing its buying teams together follows a move to combine its online and store supply chains and finance teams.

In the new structure, Walmart created six category teams (e.g., food, consumables, apparel, and entertainment) that are each managed by an executive. Restructuring and centralizing merchandising added to the company's product assortment online and made prices as well as the shopper experience more consistent. Walmart's expansion of its online-meets-in-store strategy facilitates its ability to offer a seamless experience on mobile, desktop, or traditional retail spaces. If Walmart can perfect this omnichannel strategy, it will have a major leg up on e-commerce competitor Amazon.[1]

Did you know?

There are approximately 10,500 Walmart stores in 24 countries.

Successful companies like Walmart use multiple avenues of distribution, which helps give them a sustainable competitive advantage. Nearly 2 million firms in the United States help to move products from producers to consumers. Store chains such as Dollar General, Starbucks, Forever 21, and Target operate retail outlets where consumers make purchases. Some retailers, such as Avon Products and Arbonne, send their salespeople to the homes of customers. Other retailers, such as Lands' End and REI, sell in stores, online, through catalogs, or a combination of the three. Still others, such as Amazon, sell primarily online.

In this chapter, we first examine the various distribution channels through which products move as they progress from producer to ultimate user as well as supply chain management. Then we discuss wholesalers, including their types and the services they provide. Next, we focus on retailers, including online retailing, retail stores, shopping centers, and nonstore retailing. We then explore the logistics function and the major modes of transportation that are used to move goods. We then turn our attention to integrated marketing communication and the elements of the promotion mix. Finally, we discuss each element of the promotion mix: advertising, personal selling, sales promotion, and public relations.

13-1 Distribution Channels and Market Coverage

Learning Objective

13-1 Examine the various distribution channels and market coverage of products.

A **distribution channel (**or **marketing channel)** is a sequence of marketing organizations that directs a product from the producer to the ultimate user. Every marketing channel begins with the producer and ends with either the consumer or the business user. A marketing organization that links a producer and user within a marketing channel is called a **middleman (**or **marketing intermediary)**. For the most part, middlemen are concerned with the transfer of *ownership* of products along their journey from producer to customer. In many cases, intermediaries handle the product, including its ownership, and add their own value as they move it along the distribution channel. Let's take a closer look at these channels and intermediaries.

13-1a Commonly Used Distribution Channels

Different channels of distribution generally are used to move consumer and business products. Figure 13-1 illustrates the most common distribution channels for consumer and business products.

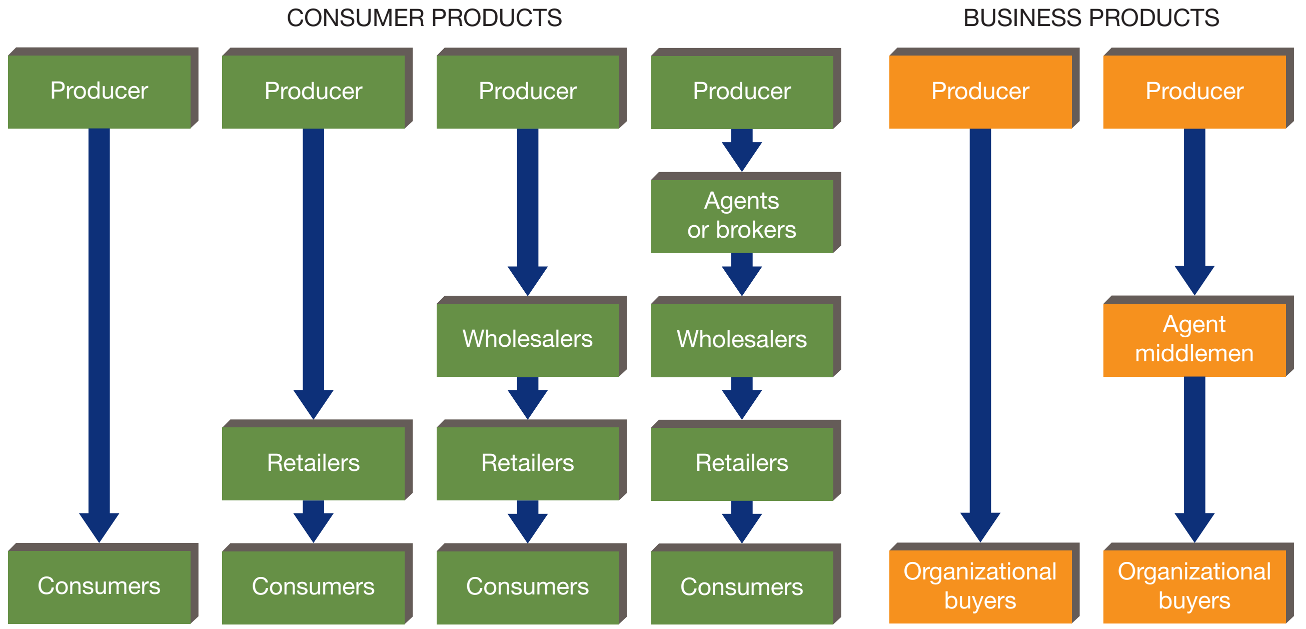
Producer to Consumer This channel, often called the *direct channel*, has no marketing intermediaries. Most services and a few consumer goods are distributed through a direct channel. If you buy a laptop directly from Apple's or Dell's website, you are using a direct channel. Direct marketing via the internet has become a critically important part of many companies' distribution strategies, often as a complement to selling products in retail stores. A growing number of companies have disrupted their industries by selling directly to consumers online using a *direct-to-consumer (D2C)* strategy, including Warby Parker, Casper, Bonobos, and Glossier.

Producers sell directly to consumers for several reasons. They can better control the quality and price of their products. They can maintain closer relationships with customers and better understand their needs. Also, they do not have to pay (through discounts) for the services of intermediaries.

distribution channel (or **marketing channel)** a sequence of marketing organizations that directs a product from the producer to the ultimate user

middleman (or **marketing intermediary)** a marketing organization that links a producer and user within a marketing channel

Figure 13-1 Distribution Channels


CONSUMER PRODUCTS
BUSINESS PRODUCTS
Producer
Producer
Producer
Producer
Producer
Producer
Agents or brokers
Wholesalers
Wholesalers
Agent middlemen
Retailers
Retailers
Retailers
Consumers
Consumers
Consumers
Consumers
Organizational buyers
Organizational buyers

ISTOCK.COM/MEDIAPHOTOS

Using multiple marketing channels. Sometimes, companies use multiple marketing channels rather than just one. College textbook publishers often sell their products through multiple marketing channels. This textbook can be purchased directly from the publisher. It can also be purchased at a campus bookstore, or through Amazon.

Producer to Retailer to Consumer A **retailer** is an intermediary that buys from producers or other middlemen and sells to consumers. Producers sell directly to retailers when the retailers are large enough to buy in large quantities. This channel is used most often for products that are bulky, such as furniture and automobiles, for which additional handling would increase marketing costs. It is also the usual channel for perishable products, such as fruits and vegetables, and for clothing.

Producer to Wholesaler to Retailer to Consumer This channel is known as the *traditional channel* because many consumer goods (especially convenience goods) pass through wholesalers to retailers. A **wholesaler** is an intermediary that sells products to other firms. These businesses may be retailers, industrial users, or other wholesalers. A producer uses wholesalers when its products are carried by so many retailers that the producer cannot manage and distribute all of them. For example, chewing gum and candy manufacturers often use this type of channel.

Producer to Agent to Wholesaler to Retailer to Consumer Producers can use agents to reach wholesalers. Agents are functional middlemen that do not take title to products and are compensated by commissions paid by producers. Often the products with which agents deal are inexpensive, frequently purchased items. For example, to reach a large number of potential customers, a small manufacturer of gas-powered lawn trimmers might choose to use agents to market them to wholesalers. The wholesalers then sell the product to a large network of retailers. This channel is also used for seasonal products (such as Christmas decorations) and by producers that do not have in-house sales forces.

Producer to Organizational Buyer In this direct channel, the manufacturer's own sales force sells directly to organizational buyers, or business users. Heavy machinery, aircraft, and major equipment usually are distributed in this way. The very short channel allows the producer to understand customers' specific needs and to provide them with expert and timely services, such as delivery, machinery installation, and repairs.

Producer to Agent Middleman to Organizational Buyer Manufacturers use this channel to distribute such items as operating supplies, accessory equipment, small tools, and standardized parts. The agent is an independent intermediary between the producer and the user. Agents generally represent sellers.

Using Multiple Channels Often a manufacturer uses different distribution channels to reach different market segments. For example, candy bars may be sold through channels containing wholesalers and retailers, as well as channels in which the producer sells them directly through large retailers. Today, businesses are likely to engage in **multichannel** (or **omnichannel) distribution**—the use of a variety of marketing channels to ensure maximum distribution. Dell, for example, sells computers direct, through its own website, as well as through strategically chosen retailers like Best Buy. Multiple channels are also used to increase sales or to capture a larger share of the market with the goal of selling as much merchandise as possible. Some products forgo physical distribution altogether: **Digital distribution** involves delivering content through the internet to a computer or other device. For example, when you stream content on Netflix

retailer an intermediary that buys from producers or other middlemen and sells to consumers

wholesaler an intermediary that sells products to other firms

multichannel (or **omnichannel) distribution** the use of a variety of marketing channels to ensure maximum distribution

digital distribution delivering content through the internet to a computer or other device or Spotify, subscribe to Office 365 software, or book a rental through Airbnb, you are making use of a digital distribution channel.

13-1b **Level of Market Coverage**

As with other marketing decisions, producers must analyze all relevant factors when deciding which distribution channels and intermediaries to use. Marketers should weigh the firm's production capabilities and marketing resources, the target market and buying patterns of potential customers, and the product itself. After evaluating these factors, the producer chooses the appropriate level of *intensity of market coverage*. Then the producer selects channels and intermediaries to implement that coverage.

Intensive distribution is the use of all available outlets for a product. It gives a product the widest possible exposure in the marketplace. The manufacturer reaches the market by selling to any intermediary of good financial standing that is willing to stock and sell the product. For the consumer, intensive distribution means being able to shop at a convenient store and spend minimum time selecting and buying the product. Many convenience goods, including candy, gum, and soft drinks, are distributed intensively.

Selective distribution is the use of only a portion of the available outlets for a product in each geographic area. Manufacturers of goods such as furniture, major home appliances, and clothing typically prefer selective distribution. For instance, you may prefer Hanes brand socks, which are distributed through retailers such as Target and Kohl's.

Exclusive distribution is the use of only a single retail outlet for a product in a large geographic area. Exclusive distribution usually is limited to prestigious products. It is appropriate, for instance, for specialty goods such as grand pianos, fine china, and expensive jewelry. The producer usually places many requirements (such as inventory levels, sales training, service quality, and warranty procedures) on exclusive dealers. For example, Patek Philippe watches, which may sell for $500,000 or more, are available in only a few select locations.

✓ Concept Check

- How do the different types of intermediaries link a producer to a user within a marketing channel?
- Describe the six distribution channels. Give an example of each.
- Explain the three intensities of market coverage. Which types of products are generally associated with each of the different intensity levels?

13-2 Partnering Through Supply Chain Management

Learning Objective

13-2 Explain how supply chain management facilitates partnering among channel members.

Supply chain management refers to the coordination of all marketing channel activities associated with the flow and transformation of supplies, products, and information throughout the supply chain to the ultimate consumer. It requires cooperation throughout the entire marketing channel, including manufacturing, research, sales, advertising, and shipping. Supply chains focus not only on producers, wholesalers, retailers, and customers, but also on component-parts suppliers, shipping companies, communication companies, and other organizations that participate in product distribution. Suppliers strongly influence what items retail stores carry.

Supply chain management encourages cooperation in reducing the costs of inventory, transportation, administration, and handling. It also accelerates order-cycle times and increases profits for all channel members. When buyers, sellers, marketing intermediaries, and facilitating agencies work together, customers' needs regarding delivery, scheduling, packaging, and other requirements are better met. As an example, Procter & Gamble developed new packaging for its leading laundry brands to make them easier to ship to customers who order them from online retailers. The new packaging for Tide laundry detergent concentrates the liquid in a sealed bag with a dripless spout inside of a shoe-box sized container, which Amazon and other online retailers can ship without additional packaging. The new designs are environmentally friendlier and provide greater value for retailers, shippers, and customers.[2]

intensive distribution the use of all available outlets for a product

selective distribution the use of only a portion of the available outlets for a product in each geographic area

exclusive distribution the use of only a single retail outlet for a product in a large geographic area

supply chain management the coordination of all marketing channel activities associated with the flow and transformation of supplies, products, and information throughout the supply chain to the ultimate consumer

Sustaining the Planet

Millennials Take a Shining to Ethically Sourced Diamonds

Diamonds are thought to be synonymous with love, but it's love for planet Earth that's leading to their downfall. Diamonds, which are mined from the earth, are inherently unsustainable. A new wave of jewelry makers is using lab-grown and recycled diamonds as well as recycled metals to appeal to Millennials. De Beers, an international diamond mining company, popularized the diamond engagement ring in the 1940s, a time when the company controlled 90 percent of the diamond market. Millennials often see through marketing ploys and are more focused on ethics, social responsibility, and sustainability than prior generations, a trend that seems likely to continue with Generation Z.

Man-made diamonds are chemically the same as natural diamonds. They both have the same crystal structure and are assigned the same grades based on the four Cs: carat, cut, clarity, and color. Plus, lab-grown diamonds tend to be more affordable than diamonds that are mined from the earth. The Diamond Producers Association implied that lab-grown diamonds are not real in its "Real Is Rare, Real Is a Diamond" smear campaign, but the Federal Trade Commission responded by issuing new guidelines that established lab-grown diamonds are in fact "real."

This new crop of sustainable jewelry makers is forcing old-school jewelry companies to adapt. Though retailers initially attempted to discredit and disparage lab-grown diamonds, the tactic flopped. Kay Jewelers and Jared, for example, now offer lab-created diamond jewelry as well. Despite the rise in sustainable diamond sales, the jewelry industry as a whole is grappling with declining consumer demand. Every segment (mass, premium, and luxury) has been affected. Eco-friendly jewelry companies and traditional jewelers alike have been negatively affected by declining marriage rates. Traditional jewelers are now on board with the eco-friendly alternative because it could spark more excitement and attract a new generation of customers.

Sources: Based on information in Pamela N. Danziger, "Lab-Grown and Natural Diamond Industries End Hostilities, as Declining Jewelry Demand Threatens All," *Forbes*, July 19, 2020, www.forbes.com/sites/pamdanziger/2020/07/19/lab-grown-and-natural-diamond-factions-settle-hostilities-as-declining-jewelry-demand-threatens-all; Lane Florsheim, "For Engagement Rings, Are Natural Diamonds on the Way Out?" *The Wall Street Journal*, September 25, 2020, www.wsj.com/articles/for-engagement-rings-are-natural-diamonds-on-the-way-out-11601045092; Stephanie Osmanski, "Why You Should Consider Ethical and Sustainable Diamonds," *Green Matters*, May 20, 2019, /www.greenmatters.com/p/ethical-sustainable-diamonds.

Technology has enhanced the implementation of supply chain management significantly. Through computerized integrated information sharing, channel members reduce costs and improve customer service. Additionally, technologies such as blockchain, artificial intelligence (AI), and robotics can help improve efficiency, responsiveness, and transparency throughout the supply chain. DHL, for example, has invested more than $300 million in AI and robotics technologies for the benefits of its customers. AI helps the shipping company analyze its supply chain to identify areas for improvement, while specialized robots have increased the company's productivity and safety by reducing mistakes and shortening the time required for routine or physically demanding activities.[3] As many major industries transform their processes, the end result is increased productivity by reducing inventory, shortening cycle time, and reducing wasted human effort.

✓ Concept Check

- How does supply chain management encourage cooperation between buyers and sellers?
- How has technology enhanced the implementation of supply-chain management?

13-3 Marketing Intermediaries: Wholesalers

Learning Objective

13-3 Describe the types of wholesalers and the services they provide.

Wholesalers are possibly the most misunderstood of marketing intermediaries. Producers sometimes try to cut out wholesalers in favor of dealing directly with retailers or consumers. However, wholesalers increase distribution efficiency. The marketing activities performed by wholesalers *must* be performed by other channel members if wholesalers are eliminated, which means that cutting out wholesalers may not reduce distribution costs.

ISTOCK.COM/ALVAREZ

Wholesalers facilitate trade by connecting manufacturers with retailers. A general-merchandise wholesaler buys many types of products from a broad range of manufacturers, warehouses the products, and then sells them to retailers. So, instead of having to contact hundreds of different manufacturers to stock their shelves, retailers need to contact only a small number of wholesalers.

13-3a Wholesalers Provide Services to Retailers and Manufacturers

Wholesalers help retailers by:

- Buying in large quantities and selling to retailers in smaller quantities and delivering goods to retailers.
- Stocking in one place the variety of goods that retailers otherwise would have to buy from many producers.
- Providing assistance in other vital areas, including promotion, market information, and financial aid.

Wholesalers help manufacturers by:

- Performing functions similar to those provided to retailers.
- Providing a sales force, reducing inventory costs, assuming credit risks, and furnishing market information.

13-3b Types of Wholesalers

Wholesalers generally fall into two categories: merchant wholesalers, and agents and brokers. Of these, merchant wholesalers constitute the largest portion. They account for about four-fifths of all wholesale establishments and employees.

Merchant Wholesalers A **merchant wholesaler** is an intermediary that purchases goods in large quantities and sells them to other wholesalers or retailers and to institutional, farm, government, professional, or industrial users.

Merchant wholesalers have the following characteristics:

- They usually operate one or more warehouses at which they receive, take title to, and store goods. These wholesalers are sometimes called *distributors* or *jobbers*.
- Most merchant wholesalers are businesses composed of salespeople, order takers, receiving and shipping clerks, inventory managers, and office personnel.
- The successful merchant wholesaler must analyze available products and market needs. It must be able to adapt the type, variety, and quality of its products to changing market conditions.
- Merchant wholesalers may be classified as full-service or limited-service wholesalers depending on the number of services they provide. A **full-service wholesaler** performs the entire range of wholesaler functions. These functions

merchant wholesaler an intermediary that purchases goods in large quantities and sells them to other wholesalers or retailers and to institutional, farm, government, professional, or industrial users

full-service wholesaler an intermediary that performs the entire range of wholesaler functions include delivering goods, supplying warehousing, arranging for credit, supporting promotional activities, and providing general customer assistance.

A full-service wholesaler can be of the following three different types:

- A **general-merchandise wholesaler** deals in a wide variety of products, such as over-the-counter medications, hardware, nonperishable foods, cosmetics, detergents, and tobacco.
- A **limited-line wholesaler** stocks only a few product lines but carries numerous product items within each line.
- A **specialty wholesaler** carries a select group of products within a single line. Food delicacies, such as shellfish, represent a product handled by this type of wholesaler. One type of specialty wholesaler you may encounter is a *rack jobber,* which owns and stocks display racks in supermarkets, drugstores, and discount and variety stores.

Agents and Brokers Agents and brokers perform a small number of marketing activities and are paid a commission that is a percentage of the sales price. They do not take ownership of the products they carry.

An **agent** is an intermediary that expedites exchanges, represents a buyer or a seller, and often is hired permanently on a commission basis. When agents represent producers, they are known as *sales agents* or *manufacturer's agents*. As long as the products represented do not compete, a sales agent may represent one or several manufacturers on a commission basis. The agent solicits orders for the manufacturers within a specific territory. As a rule, the manufacturers ship the merchandise and bill the customers directly. The manufacturers also set the prices and other conditions of the sales. The sales agent provides immediate entry into a territory, regular calls on customers, selling experience, and a known, predetermined selling expense (a commission that is a percentage of sales revenue).

A **broker** is an intermediary that specializes in a particular commodity, represents either a buyer or a seller, and is likely to be hired on a temporary basis. Food brokers that sell grocery products to resellers are the exception to this rule. They generally have long-term relationships with clients. Brokers may perform only the selling function or both buying and selling using their established contacts and specialized knowledge of their fields.

✓ Concept Check

- What services do wholesalers provide to producers and to retailers?
- Identify and describe the various types of wholesalers.

13-4 Marketing Intermediaries: Retailers

Learning Objective

13-4 Distinguish among the major types of retailers and shopping centers.

Retailers are the final link between producers and consumers. Retailers may buy from either wholesalers or producers. They can sell goods, services (such as auto repairs or haircuts), or both. Home Depot, for instance, sells consumer goods, financial services, and installation and repair services for home appliances purchased at Home Depot.

The U.S. Bureau of Labor Statistics reports that the United States has about 1 million retail establishments ringing up total sales of more than $4 trillion.[4] Most retailers are small, with annual revenues well under $1 million. However, some retailers are quite large, with hundreds or even thousands of stores. Table 13-1 lists the ten largest retail organizations in the United States, their sales revenues, and number of stores. In recent years, conventional retail stores have faced numerous challenges, including changing consumer habits, the growth of online shopping, and the COVID-19 pandemic.

13-4a Online and Multichannel Retailing

As you probably know from firsthand experience, **online retailing** makes products available to buyers through computer or mobile connections. Online retailing is a rapidly growing segment with sales expected to exceed $1 trillion by 2023;

general-merchandise wholesaler an intermediary that deals in a wide variety of products

limited-line wholesaler an intermediary that stocks only a few product lines but carries numerous product items within each line

specialty wholesaler an intermediary that carries a select group of products within a single line

agent an intermediary that expedites exchanges, represents a buyer or a seller, and often is hired permanently on a commission basis

broker an intermediary that specializes in a particular commodity, represents either a buyer or a seller, and is likely to be hired on a temporary basis

online retailing retailing that makes products available to buyers through computer or mobile connections

Table 13-1 The Ten Largest U.S. Retailers

Rank	Company	Sales (in billions)	# of Stores
1	Walmart	$524.0	5,355
2	Amazon	$250.5	564
3	Costco	$152.7	542
4	Walgreens Boots Alliance	$136.9	9,168
5	Kroger	$122.3	3,003
6	Home Depot	$110.5	1,973
7	CVS Health	$88.5	9,909
8	Target	$77.1	1,868
9	Lowe's	$72.2	1,727
10	Albertsons	$62.4	2,258

Source: National Retail Federation, "Top 100 Retailers 2020 List," https://nrf.com/resources/top-retailers/top-100-retailers/top-100-retailers-2020-list (accessed March 22, 2021).

online purchases now account for 19 percent of all retail sales and are expected to grow to 33 percent by 2030.[5] Business and consumer spending on sites like Amazon, Alibaba, and Jet have come at the expense of conventional stores. To remain competitive, most retailers today have websites to sell products, provide information about their company, and offer incentives. Nordstrom, for example, gets more than one-half of its sales online, and its online presence supports its conventional stores.[6] Larger retailers like Starbucks, Best Buy, and Kohl's also have their own apps for customers to carry out retailing activities on their tablets or smartphones wherever they may be. Starbucks' app, for example, allows customers to order and pay right from their phone as well as accumulate loyalty reward points, while Target's app lets customers shop online and arrange for pickup or delivery or to find products in the store and identify coupons and other savings.

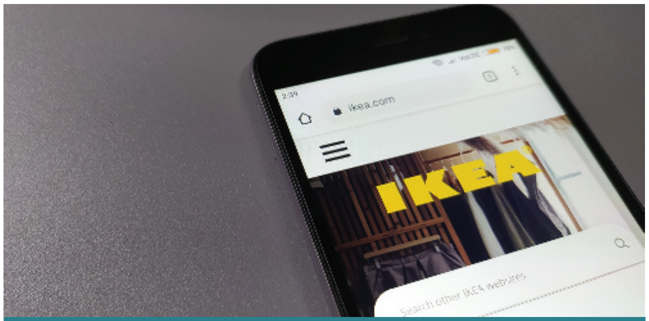
Many retailers today actually engage in **multichannel retailing** by employing multiple types of retailing. These retailers integrate a particular combination of brick-and-mortar stores, websites, apps, catalogs, direct-response marketing, telemarketing, and even vending so that a customer can research a product and purchase it from home, work, or in the car. D2C mattress retailer Casper, for example, has opened brick-and-mortar stores where customers can try out its mattresses before they buy. The company also has partnerships with retailers such as Sam's Club and Ashley HomeStore so that consumers can try out mattresses. These stores complement Casper's online efforts by opening more avenues for interacting with customers wherever they want to shop.[7]

multichannel retailing employing multiple types of retailing

independent retailer a firm that operates only one retail outlet

chain retailer a company that operates more than one retail outlet

KASPIAN/SHUTTERSTOCK.COM



Utilizing multiple retail approaches. Many retailers use multichannel retailing to reach potential customers. IKEA operates more than 455 retail stores in 52 countries. It also engages in direct marketing through online retailing.

13-4b Types of Retail Stores

One way to classify retailers is by the number of stores owned and operated by the firm.

1. An **independent retailer** is a firm that operates only one retail outlet. Most retailers are independent, one-store operators that generally provide personal service and a convenient location.
2. A **chain retailer** is a company that operates more than one retail outlet. By adding outlets, chain retailers reach new geographic markets. As sales increase, chains usually buy merchandise in larger

ISTOCK.COM/ROBERT WAY

Accessing customers through different types of retailers. When people are asked to name a retailer, they often think of brick-and-mortar establishments like the one shown in this photo. However, retailing goes on in all kinds of places, including in people's homes and workplaces, online, over the phone and on TV, and even on the streets.

quantities and thus take advantage of quantity discounts. They also wield more power in their dealings with suppliers. There are many fewer chain retail organizations than independent retailers.

Another way to classify retail stores is by store size and the kind and number of products carried. We will now take a closer look at store types based on these dimensions.

Department Stores These large retail establishments consist of several sections, or departments, that sell a wide assortment of products. The U.S. Census Bureau defines a **department store** as a retail store that (1) employs 25 or more persons and (2) sells at least home furnishings, appliances, family apparel, and household linens and dry goods, each in a different part of the store. Macy's, Kohl's, Selfridges, and Printemps are examples of large, international, department stores. Traditionally, department stores have been service-oriented. Along with the goods they sell, these retailers provide credit, personal assistance, liberal return policies, and pleasant shopping atmospheres.

Discount Stores A **discount store** is a self-service general-merchandise outlet that sells products at lower-than-usual prices. Stores like Target and Walmart operate on smaller markups and higher merchandise turnover than other retailers and offer minimal customer services. There has been a rise of extreme-value stores like Dollar General and Dollar Tree, which are a fraction of the size of conventional discount stores and typically offer very low prices on smaller-size name-brand nonperishable household items.

Warehouse Showrooms A **warehouse showroom** is a retail facility with five basic characteristics: (1) a large, low-cost building, (2) warehouse materials-handling technology, (3) vertical merchandise displays, (4) a large, on-premises inventory, and (5) minimal service. Some of the best-known showrooms are operated by big furniture retailers, including IKEA. These operations employ few personnel and offer few services. Most customers carry away purchases in the manufacturer's carton and assemble the products themselves, although some warehouse showrooms will deliver for a fee.

Convenience Stores A **convenience store** is a small food store that sells a limited variety of products but remains open well beyond normal business hours. Because convenience stores are common, most patrons of a particular store live within a mile of it. 7-Eleven, Circle K, Turkey Hill, and Open Pantry stores, for example, are convenience stores found either regionally or nationally in the United States. Limited product mixes and higher prices keep convenience stores from threatening the business of other grocery retailers. There are more than 150,000 convenience stores in the United States.[8]

Supermarkets A **supermarket** is a large self-service store that sells primarily food and household products. It stocks fresh, canned, frozen, and processed foods, paper products, and cleaning supplies. Sometimes called grocery stores, supermarkets also may sell such items as housewares, toiletries, toys and games, pharmacy products, stationery, books and magazines, plants and flowers, and a few clothing items. Supermarkets like Kroger, Albertsons, and H-E-B are large-scale operations that emphasize low prices and one-stop shopping for household needs.

Superstores A **superstore** is a large retail store that carries not only food and nonfood products ordinarily found in supermarkets, but also additional product lines

department store a retail store that (1) employs 25 or more persons and (2) sells at least home furnishings, appliances, family apparel, and household linens and dry goods, each in a different part of the store

discount store a self-service general-merchandise outlet that sells products at lower-than-usual prices

warehouse showroom a retail facility in a large, low-cost building with a large on-premises inventory and minimal service

convenience store a small food store that sells a limited variety of products but remains open well beyond normal business hours

supermarket a large self-service store that sells primarily food and household products

superstore a large retail store that carries not only food and nonfood products ordinarily found in supermarkets but also additional product lines such as housewares, hardware, small appliances, clothing, personal-care products, garden products, and automotive merchandise. Superstores also provide services, including automotive repair, snack bars and restaurants, photo printing, and banking. Target, Walmart, and H-E-B operate some superstores.

ISTOCK.COM/SUNDRY PHOTOGRAPHY

Killing the competition? Or not? Home Depot is an example of a category killer. Category killers aren't likely to annihilate all of the competition though. Small retailers with less product variety and higher prices have found it difficult to compete against category killers. However, small retailers that carry a smaller inventory of products that are different from those stocked by category killers and compete on the basis of service, rather than price, can survive.

Warehouse Clubs The **warehouse club** is a large-scale members-only establishment that combines features of cash-and-carry wholesaling with discount retailing. For an annual fee, small retailers or individuals may become members and purchase products at low prices for business use, for resale, or for personal use. Because their product lines are shallow and sales volumes are high, warehouse clubs like Sam's Club and Costco can offer a broad range of merchandise, including perishable and nonperishable foods, beverages, books, appliances, housewares, automotive parts, hardware, and furniture.

Traditional Specialty Stores A **traditional specialty store** carries a narrow product mix with deep product lines. Traditional specialty stores are sometimes called *limited-line retailers*. If they have depth in one product category, such as baked goods or jewelry, they may be called *single-line retailers*. Specialty stores usually offer deeper product mixes than department stores. They attract customers by emphasizing service, atmosphere, and location. Consumers who are dissatisfied with the impersonal atmosphere of large retailers often find the attention offered by specialty stores appealing. Specialty stores include chains such as the Gap, Bath and Body Works, and Foot Locker, as well as many independent stores.

Off-Price Retailers An **off-price retailer** is a store that buys manufacturers' seconds, overruns, returns, and off-season merchandise at below-wholesale prices and sells them to consumers at deep discounts. Off-price retailers sell limited lines of national-brand and designer merchandise, usually clothing, shoes, or housewares. Off-price retailers include T.J. Maxx, Burlington, and Ross. Off-price stores charge up to 50 percent less than department stores for comparable merchandise but offer few customer services. They often include community dressing rooms and central checkout counters. Some off-price retailers have a no-returns, no-exchanges policy.

Category Killers A **category killer** is a very large specialty store that concentrates on a single product line and competes by offering low prices and an enormous number of products. These stores are called *category killers* because they take business away from smaller, higher-priced retail stores. Category killers such as PetSmart and Office Depot are seeing increased competition from online retailing. The cost of maintaining such large stores can drain a company of its profits.

13-4c Types of Shopping Centers

There are several different types of shopping centers where retailers can choose to locate. A *planned shopping center* is a self-contained retail facility operated by independent owners and consisting of various stores. Shopping centers are designed and promoted to serve diverse groups of customers with widely differing needs. The management of a shopping center strives for a coordinated mix of stores, a comfortable atmosphere, adequate parking, pleasant landscaping, and special events to attract customers. The convenience of shopping for most family and household

warehouse club a large-scale members-only establishment that combines features of cash-and-carry wholesaling with discount retailing

traditional specialty store a store that carries a narrow product mix with deep product lines

off-price retailer a store that buys manufacturers' seconds, overruns, returns, and off-season merchandise for resale to consumers at deep discounts

category killer a very large specialty store that concentrates on a single product line and competes on the basis of low prices and product availability

KIT LEONG/SHUTTERSTOCK.COM

Lifestyle shopping center. Lifestyle shopping centers include specialty retailers, restaurants, and areas for cultural activities in an open-air setting.

needs in a single location is an important element of shopping-center appeal. There are several types of shopping centers: lifestyle, neighborhood, community, or regional.

A **lifestyle shopping center** is a shopping center that has an open-air configuration and is occupied primarily by upscale national chain specialty stores. The lifestyle shopping center model is popular because it combines shopping with the feel of strolling along Main Street. Some lifestyle shopping centers, like The Domain in Austin, Texas, include residences and offices above the stores, as well as activities and culture in their design in order to attract a wide variety of people.

A **neighborhood shopping center**, also called a *strip mall,* typically consists of several small convenience and specialty stores. Businesses in neighborhood shopping centers might include small grocery stores, drugstores, gas stations, and fast-food restaurants. These retailers serve consumers who live less than ten minutes away, usually within a two- to three-mile radius. Unlike in a lifestyle shopping center, most purchases in the neighborhood shopping center are based on convenience or personal contact. These retailers generally make only limited efforts to coordinate their promotional activities.

A **community shopping center** includes one or two department stores and some specialty stores, along with convenience stores. It attracts consumers from a wider geographic area who will drive longer distances to find products and specialty items unavailable in neighborhood shopping centers. Community shopping centers, which are carefully planned and coordinated, generate traffic with special events such as art exhibits, automobile shows, and sidewalk sales. The management of a community shopping center maintains a mix of tenants so that the center offers wide product mixes and deep product lines.

A **regional shopping center** usually has large department stores, numerous specialty stores, restaurants, movie theaters, and sometimes even hotels. It carries a similar mix of merchandise to that available in a downtown shopping district. Regional shopping centers carefully coordinate management and marketing activities to reach the 150,000 or more customers in their target market. These large centers usually advertise, hold special events, and may even provide transportation for customers. National chain stores can gain leases in regional shopping centers more easily than small independent stores because they are better able to meet the centers' financial requirements.

In addition to these types of shopping centers, outlet malls feature discount and factory outlet stores carrying traditional manufacturer brands, such as Polo Ralph Lauren, Nike, Guess, and Sunglass Hut. Some outlet centers feature upscale products from last season, discounted for quick sale. Manufacturers own these stores and make a special effort to avoid conflict with traditional retailers of their products. Manufacturers place these stores in noncompetitive locations, often outside of metropolitan areas. Factory outlet centers attract value-conscious customers seeking quality and major brand names. They operate in much the same way as regional shopping centers, but usually draw customers, some of whom may be tourists, from a larger shopping radius.

lifestyle shopping center an open-air-environment shopping center with upscale chain specialty stores

neighborhood shopping center a planned shopping center consisting of several small convenience and specialty stores

community shopping center a planned shopping center that includes one or two department stores and some specialty stores, along with convenience stores

regional shopping center a planned shopping center containing large department stores, numerous specialty stores, restaurants, movie theaters, and sometimes even hotels

nonstore retailing selling that does not take place in conventional store facilities

13-4d Nonstore Retailing

Nonstore retailing is selling that does not take place in conventional store facilities. Consumers may purchase products without ever visiting a store. This form of retailing accounts for an increasing percentage of total retail sales. Nonstore retailers use direct selling, direct marketing, and vending.

Direct Selling **Direct selling** is the marketing of products to customers through face-to-face sales presentations at home or in the workplace. Traditionally called *door-to-door selling,* direct selling in the United States began with peddlers more than a century ago and is now a major industry with $35 billion in U.S. sales annually.[9] Instead of the door-to-door approach, many companies today—such as Mary Kay, Amway, and Avon—use other approaches. They can identify customers by mail, telephone, or the internet and then set up appointments. Direct selling sometimes involves the "party plan," which can occur in the customer's home or workplace. Direct selling through the party plan requires effective salespeople who identify potential hosts and provide encouragement and incentives for them to organize a gathering. Companies that commonly use the party plan are Tupperware, Cutco, and Pampered Chef.

Direct Marketing **Direct marketing** is the use of the telephone, internet, and nonpersonal media to communicate product and organizational information to customers, who then can purchase products via mail, telephone, or the internet. Direct marketing can occur online (discussed earlier) and through catalog marketing, direct-response marketing, telemarketing, and television home shopping.

In **catalog marketing**, an organization provides a catalog from which customers make selections and place orders by mail, telephone, or the internet. Catalog marketing began in 1872 when Montgomery Ward issued its first catalog to rural families. There are thousands of catalog marketing companies in the United States, many of which publish online. Some catalog marketers sell products spread over multiple product lines, while others are more specialized. Catalog companies, such as Burpee (seeds and plants) and Coldwater Creek (women's apparel), offer considerable depth in only one major product line. The advantages of catalog marketing include efficiency and convenience for customers because they do not have to visit a store. The retailer benefits by being able to locate in remote, low-cost areas, save on expensive store fixtures, and reduce both personal selling and store operating expenses. Disadvantages are that catalog marketing is inflexible, provides limited service, and is most effective for only a selected set of products.

Direct-response marketing occurs when a retailer advertises a product and makes it available through mail, telephone, or online orders. This marketing method has resulted in some products gaining widespread popularity. You may have heard of the Shamwow, Snuggie, and Magic Bullet—all of which became popular through direct response television marketing campaigns. Direct-response marketing can also be conducted by sending letters, samples, brochures, or booklets to prospects on a mailing list.

Telemarketing is the performance of marketing-related activities by telephone. Some organizations use a prescreened list of prospective clients. Telemarketing has many advantages, such as generating sales leads, improving customer service, speeding up payments on past-due accounts, raising funds for nonprofit organizations, and gathering market data. However, many consumers do not like being contacted by marketers via the phone and increasingly restrictive telemarketing laws have made it a less appealing marketing method. In 2003, U.S. Congress implemented a national do-not-call registry, which lists more than 241 million people who wish to opt out of telemarketing calls. Companies that make telemarketing phone calls must pay for access to the do-not-call registry and must obtain updated numbers from the registry at least every three days. The Federal Trade Commission (FTC) enforces violations, and companies are subject to fines of up to $16,000 for each call made to numbers on the list. The Federal Communications Commission (FCC) further outlaws prerecorded calls—"robocalls"—from companies for marketing purposes. However, new technologies mean that some unscrupulous firms are increasingly ignoring the National Do Not Call Registry and using robocalls for telemarketing purposes.[10]

Television home shopping presents products to television viewers, encouraging them to order through toll-free numbers and pay with credit cards.

direct selling the marketing of products to customers through face-to-face sales presentations at home or in the workplace

direct marketing the use of the telephone, internet, and nonpersonal media to introduce products to customers, who then can purchase them via mail, telephone, or the internet

catalog marketing a type of marketing in which an organization provides a catalog from which customers make selections and place orders by mail, telephone, or the internet

direct-response marketing a type of marketing in which a retailer advertises a product and makes it available through mail, telephone, or online orders

telemarketing the performance of marketing-related activities by telephone

television home shopping a form of selling in which products are presented to television viewers, who can buy them by calling a toll-free number and paying with a credit card

Home Shopping Network (HSN) originated and popularized this format. Most homes in the United States receive at least one home shopping channel.

✓ Concept Check

- Describe the major types of retail stores. Give an example of each.
- What are the most common types of shopping centers, and what types of store does each typically contain?
- How does nonstore retailing occur?

Vending **Vending** is the use of machines to dispense products. Vending, which accounts for less than 2 percent of all retail sales, is one of the most impersonal forms of retailing. Small, standardized, routinely purchased products can be sold in machines because they do not readily spoil and consumers appreciate the convenience. Customers can now find a wide variety of products dispensed via vending machine, even high-end items such as gold bars, cars, and iPods as well as cosmetics and food.

13-5 Logistics

Learning Objective

13-5 Identify the five most important logistics activities.

Logistics, also known as physical distribution, is all those activities concerned with the efficient flow and storage of products from the producer to the ultimate user. Logistics, therefore, is the movement of the products themselves—both goods and services—through their channels of distribution. The annual cost of business logistics in the United States is tremendous, at $1.63 trillion. To put this in perspective, logistics costs are 7.6 percent of gross domestic product (GDP).[11] It combines several interrelated business functions, the most important of which are inventory management, order processing, warehousing, materials handling, and transportation. Because these functions and their costs are highly interrelated, marketers view logistics as an integrated effort that supports other marketing activities. The overall goal of logistics is to get the right product to the right place at the right time and at minimal total cost.

vending the use of machines to dispense products

logistics all those activities concerned with the efficient flow and storage of products from the producer to the ultimate user

Technology and Innovation

Drone Delivery Takes Off

Drones, which have grown rapidly in popularity, have many potential applications for business such as inventory management, package delivery, surveillance, and aerial photography. While commercial deployment has been slow due to regulation issues, society has begun to realize, thanks to the COVID-19 pandemic, that the utility of these unmanned aerial vehicles may outweigh potential risks.

During the pandemic, when social distancing was an imperative, drone delivery pilot programs experienced a surge. For example, Wing, operated by Alphabet, has been working on making drone delivery a reality since 2012. It doubled deployment rates during the global health crisis, working with FedEx and Walgreens to deliver household goods and select food items from a local bakery in Christiansburg, Virginia. This afforded customers greater access to necessities. Likewise, JD.com, the largest retailer in China, made deliveries to rural villages and semi-isolated islands. The crisis drove changes in policy because drones were seen as a way to reduce human contact during the pandemic. For delivery programs to become widespread, regulations need to advance even further.

The Federal Aviation Administration (FAA) pushed the commercial drone market forward by creating a regulatory framework with its consumer drone registry. The pace of adoption has been slow because until recently, operators who wanted to fly a drone over people or at night needed a waiver. Drones must still be flown within the visual line of sight unless the FAA says otherwise. Wing was the first drone service to receive permission from the FAA to allow multiple pilots to operate multiple drones making deliveries simultaneously to the public. As we enter the Golden Age of drone delivery, commercial drone operators will have to work together to demonstrate to the public as well as regulators how drones benefit society.

Sources: Based on information in Harrison Wolf, "We're About to See the Golden Age of Drone Delivery – Here's Why," *World Economic Forum,* July 6, 2020, www.weforum.org/agenda/2020/07/golden-age-drone-delivery-covid-19-coronavirus-pandemic-technology; "Drone Technology Uses and Applications for Commercial, Industrial and Military Drones in 2021 and the Future," *Business Insider,* January 12, 2021, www.businessinsider.com/drone-technology-uses-applications; "FAA Outlines New Rules for Drones and Their Operators," *Los Angeles Times*, December 30, 2020, www.latimes.com/business/story/2020-12-30/faa-new-drone-rules.

13-5a **Inventory Management**

We define **inventory management** as the process of managing inventories in such a way as to minimize inventory costs, including both holding costs and potential stock-out costs. *Holding costs* are the expenses of storing products until they are purchased or shipped to customers. *Stock-out costs* are sales lost when items are not in inventory. Marketers seek to balance these two costs so that the company always has sufficient inventory to satisfy customer demand, but with little surplus because storing unsold products can be very expensive.

Holding costs include the money invested in inventory, the cost of storage space, insurance costs, and inventory taxes. Often even a relatively small reduction in inventory can generate a large increase in available working capital. Sometimes firms discover that risking some stockout costs can be cheaper than having too much inventory. Generally speaking, inventory management software helps companies maintain the correct levels of inventory and know when to place orders.

13-5b **Order Processing**

Order processing consists of activities involved in receiving and filling customers' purchase orders. It may include not only the means by which customers order products but also procedures for billing and granting credit.

Fast, efficient order processing can provide a dramatic competitive edge. Those in charge of purchasing goods for intermediaries are especially concerned with their suppliers' promptness and reliability in order processing. To them, promptness and reliability mean minimal inventory costs as well as the ability to order goods when they are needed rather than weeks in advance. The internet is providing new opportunities for improving services associated with order processing.

13-5c **Warehousing**

Warehousing is the set of activities involved in receiving and storing goods and preparing them for reshipment. Goods are stored to create time utility, meaning they are held until they are needed for use or sale. Warehousing includes the following activities:

- *Receiving goods.* The warehouse accepts delivered goods and assumes responsibility for them.
- *Identifying goods.* Records are made of the quantity of each item received. Items may be marked, coded, or tagged for identification.
- *Sorting goods.* Delivered goods may have to be sorted before being stored.
- *Dispatching goods to storage.* Items must be moved to storage areas, where they can be found later.
- *Holding goods.* The goods are protected in storage until needed.
- *Recalling, picking, and assembling goods.* Items that are to leave the warehouse must be selected from storage and assembled efficiently.
- *Dispatching shipments.* Each shipment is packaged and directed to the proper transport vehicle. Shipping and accounting documents are prepared.

A firm may use its own private warehouses or rent space in public warehouses. A *private warehouse,* owned and operated by a particular firm, can be designed to serve the firm's specific needs. However, the organization must take on the task of financing the facility and determining the best location for it.

Public warehouses are open to all individuals and firms. Most are located on the outskirts of cities, where rail and truck transportation is easily available. They provide storage facilities, areas for sorting and assembling shipments, and office and display spaces for wholesalers and retailers. Public warehouses also will hold—and issue receipts for—goods used as collateral for borrowed funds.

inventory management the process of managing inventories in such a way as to minimize inventory costs, including both holding costs and potential stock-out costs

order processing activities involved in receiving and filling customers' purchase orders

warehousing the set of activities involved in receiving and storing goods and preparing them for reshipment

13-5d **Materials Handling**

Materials handling is the actual physical handling of goods—in warehouses as well as during transportation. Proper materials-handling procedures and techniques can increase the efficiency and capacity of a firm's warehouse and transportation system, as well as reduce product breakage and spoilage. Increasingly, companies use technology such as robotics and *radio frequency identification (RFID)*—a system of tags and readers that use radio waves to identify and track materials tagged with special microchips—to facilitate efficient handling.

Materials handling attempts to reduce the number of times a product is handled. One method is called *unit loading*. Several smaller cartons, barrels, or boxes are combined into a single standard-size load that can be moved efficiently by forklift, conveyer, robot, or truck. Another is *containerization*, which involves consolidating many items into single, large containers that are sealed at their point of origin and opened at their destination. Their uniform size means they can be stacked and shipped via train, barge, or ship.

13-5e **Transportation**

As a part of logistics, **transportation** is simply the shipment of products to customers. Transportation in the United States costs $1.06 trillion a year, 65 percent of total logistics activities' costs.[12] The greater the distance between seller and purchaser, the more important is the choice of the mode of transportation and the particular carrier. In recent years, the internet has emerged as a mode of transportation for digital products like streamed entertainment products such as songs and TV shows and downloadable products such as software.

A firm that offers transportation services is called a **carrier**. A *common carrier* is a transportation firm whose services are available to all shippers. Railroads, airlines, and most long-distance trucking firms are common carriers. A *contract carrier* is available for hire by one or several shippers. Contract carriers do not serve the general public and the number of firms they can handle at a time is limited by law. A *private carrier* is owned and operated by the shipper.

There are six major criteria that marketers use for selecting transportation modes: cost, speed, dependability, load flexibility, accessibility, and frequency. Table 13-2 compares these.

Obviously, the *cost* of a transportation mode is an important consideration. However, it is not the only one. Higher-cost modes of transportation can convey important benefits. *Speed* is measured by the total time that a carrier possesses the products, including time

materials handling the actual physical handling of goods, in warehouses as well as during transportation

transportation the shipment of products to customers

carrier a firm that offers transportation services

Table 13-2 Characteristics of Transportation Modes

Selection Criteria	Railroads	Trucks	Pipelines	Waterways	Airplanes	Internet
Cost	Moderate	High	Low	Very low	Very high	Very low
Speed	Average	Fast	Slow	Very slow	Very fast	Very fast
Dependability	Average	High	High	Average	High	High
Load flexibility	High	Average	Very low	Very high	Low	Low
Accessibility	High	Very high	Very limited	Limited	Average	Very high
Frequency	Low	High	Very high	Very low	Average	Very high
Products carried	Coal, grain, lumber, heavy equipment, paper and pulp products, chemicals	Clothing, computers, books, groceries and produce, livestock	Oil, processed coal, natural gas, wood chips	Chemicals, bauxite, grain, motor vehicles, agricultural implements	Flowers, food (highly perishable), technical instruments, emergency parts and equipment, overnight mail	Information, songs, TV shows, movies, software, services

required for pickup and delivery, handling, and movement between point of origin and destination. Usually there is a direct relationship between cost and speed, meaning faster modes of transportation are more expensive. A transportation mode's *dependability* is determined by its consistency of service. *Load flexibility* is the degree to which a transportation mode can be adapted for moving different kinds of products with varying requirements, such as controlled temperatures or humidity levels. *Accessibility* refers to a transportation mode's ability to move goods over a specific route or network. *Frequency* refers to how frequently a marketer can ship products by a specific transportation mode. While pipelines provide continuous shipments, railroads and waterways follow specific schedules for moving products from one location to another. Table 13-2 compares each transportation mode according to these six selection criteria.

Railroads Shipping by railroad remains one of the most important modes of transportation in the United States. Rail is also the least expensive mode for many products. Almost all railroads are common carriers, although a few coal-mining companies operate their own lines. Many commodities carried by railroads could not be transported easily by any other means.

Trucks The trucking industry consists of common, contract, and private carriers. Trucks are a very popular transportation mode because they have the advantage of being able to move goods to areas not served by railroads. They can handle freight quickly and economically, and they can carry a wide range of shipments. Many shippers favor this mode because it offers door-to-door service, less stringent packaging requirements than ships and airplanes, and flexible delivery schedules. Railroad and truck carriers sometimes team up to provide a form of transportation called *piggyback*, wherein truck trailers are loaded onto railroad flatcars for much of the distance and then pulled by trucks to the final destination.

Airplanes Air transport is the fastest, but most expensive, means of transportation. All certified airlines are common carriers. Supplemental or charter lines are contract carriers. Because of the high cost, uneven geographic distribution of airports, and reliance on weather conditions, airlines carry only a tiny fraction of intercity freight. Usually, only high-value, perishable items or goods that are needed immediately are shipped by air.

Waterways Cargo ships and barges offer the least expensive, but slowest, form of transportation. They are used mainly for bulky, nonperishable goods such as iron ore, bulk wheat, motor vehicles, and agricultural implements. Of course, shipment by water is limited to ports and cities located on navigable waterways. Many international distributors will combine this mode with a land mode to transport products to their destination.

Pipelines Pipelines are a highly specialized mode of transportation. They are used primarily to carry petroleum and natural gas. Such products as semiliquid coal and wood chips also can be shipped through pipelines, although their use can be controversial when they cut across animal migratory pathways or spring a leak in remote areas.

Internet In recent years, the internet has emerged as a mode of transportation for digital products. Examples include streamed entertainment products such as songs and TV shows and downloadable products such as software.

✓ Concept Check

- How is inventory management a balancing act between stockout costs and holding costs?
- Explain the seven major warehousing activities.
- What is the goal of materials handling?
- Describe the major characteristics of the primary transportation modes.

13-6 What Is Integrated Marketing Communications?

integrated marketing communications coordination of promotion efforts to ensure maximal informational and persuasive impact on customers

Learning Objective

13-6 Define integrated marketing communications.

Integrated marketing communications is the coordination of promotion efforts to ensure maximum informational and persuasive impact on customers. A major goal of integrated marketing communications is to send a consistent message to customers. Unilever's Dove brand, for example, ran the successful Dove Campaign for Real Beauty, which employed variations on the message in advertising on billboards, television, and online for more than a decade, with some ads being watched and shared millions of times. The brand also paired the Real Beauty messaging with its Dove Self-Esteem Project used by parents and educators to help promote confidence in children. The integrated campaign helped increase the brand's sales by $1.5 billion over ten years.[13]

Integrated marketing communications helps organizations coordinate and manage promotions in order to convey a consistent message. This approach fosters long-term customer relationships as well as the efficient use of promotional resources. The concept of integrated marketing communications has been increasingly accepted for several reasons. Mass-media advertising, a very popular promotional method in the past, is used less today because of its high costs and variable audience sizes. Marketers now take advantage of highly targeted promotional tools, such as social media, cable TV, direct mail, DVDs, the internet, special-interest magazines, and podcasts. These vehicles let marketers be more precise in targeting individual customers. As an example, affordable beauty firm e.l.f. Cosmetics uses TikTok and Instagram to reach its diverse customer base with fun and creative messaging that reinforces its brand and depicts ways customers use its products.[14]

Because the overall costs of marketing communications are significant, managers demand systematic evaluations of communications efforts to ensure that promotional resources are being used efficiently. Although the fundamental role of promotion has not changed, the specific communication vehicles employed and the precision with which they are used are evolving.

✓ Concept Check

- What is the major goal of integrated marketing communications?
- Why are integrated marketing communications being increasingly accepted?

13-7 The Promotion Mix: An Overview

Learning Objective

13-7 List the basic elements of the promotion mix.

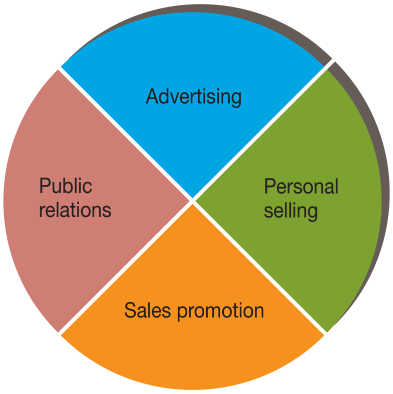
Promotion is communication about an organization and its products that is intended to inform, persuade, or remind target-market members. Promotion is not limited to business. Charities use promotion to inform us about their cause or issue, to persuade us to donate, and to remind us to do so. Even the Internal Revenue Service uses promotion (in the form of publicity) to remind us of the mid-April deadline for filing tax returns.

A **promotion mix** (sometimes called a *marketing-communications mix*) is the particular combination of promotion methods a firm uses to reach a target market. The makeup of a mix depends on many factors, including the firm's promotional resources and objectives, the nature of the target market, the product characteristics, and the feasibility of the various promotional methods. The four elements of the promotion mix are advertising, personal selling, sales promotion, and public relations, as illustrated in Figure 13-2.

Advertising is a paid nonpersonal message communicated to a select audience through a mass medium. Advertising is flexible and can reach a very large or a small, carefully chosen target group. **Personal selling** is personal communication aimed at

Figure 13-2 Possible Elements of a Promotion Mix

Depending on the type of product and target market involved, one or more of these ingredients are used in a promotion mix.



promotion communication about an organization and its products that is intended to inform, persuade, or remind target-market members

promotion mix the particular combination of promotion methods a firm uses to reach a target market

advertising a paid nonpersonal message communicated to a select audience through a mass medium

personal selling personal communication aimed at informing customers and persuading them to buy a firm's products informing customers and persuading them to buy a firm's products. It is more expensive to reach a consumer through personal selling than through advertising, but this method provides immediate feedback and often is more persuasive than advertising. **Sales promotion** is the use of activities or materials as direct inducements to customers or salespersons, which can add value to the product and increase the customer's incentive to make a purchase. **Public relations** is a broad set of communication activities used to create and maintain favorable relationships between an organization and various public groups, both internal and external. Public relations activities are numerous and varied and can be a very effective form of promotion.

In addition to deciding which combination of promotional methods is most appropriate for a marketing strategy, marketers must decide whether to use a push or pull strategy. With a *push policy,* a producer promotes the product only to the next organization down the marketing channel, and each channel member in turn promotes to the next. In a marketing channel with wholesalers and retailers, the producer promotes to the wholesaler because, in this case, the wholesaler is the channel member just below the producer. As an example, a paper wholesaler might offer an office-supply store $3 off every box of paper purchased for sale in the store; an appliance manufacturer's sales representatives might use personal selling to encourage retailers to carry a new model. Indeed, a push policy normally stresses personal selling. With a *pull policy,* however, a marketer promotes directly to consumers to spur strong consumer demand for its products. It does so primarily through advertising and sales promotion. Because consumers are persuaded to seek the products in retail stores, retailers in turn go to wholesalers or the producers to buy the products. An example of a pull policy is the Apple iPhone. Apple uses advertising to tease each new iPhone or Apple Watch, which creates demand through word-of-mouth. Consumers hear about Apple's new product and are encouraged to seek out more information. Push and pull policies are not mutually exclusive. At times, an organization uses both simultaneously.

While it is possible for a marketer to only use one ingredient of the promotion mix, it is more likely that two, three, or even all four of these ingredients will be used, depending on the type of product and target market involved.

✓ Concept Check

- What are the major elements of a promotion mix?
- How can each element help a firm reach a target market?
- How does a push strategy differ from a pull strategy?

13-8 Advertising

Learning Objective

13-8 Examine advertising, including the types of advertising, the advertising campaign, and social and legal considerations.

Advertising is a very important element of the promotion mix. Organizations currently spend around $169.9 billion annually on advertising in the United States.[15] In this section, we discuss the types of advertising and how to develop an advertising campaign.

13-8a Types of Advertising by Purpose

Depending on its purpose and message, advertising may be classified into one of three groups: primary demand, selective demand, or institutional.

Primary-Demand Advertising **Primary-demand advertising** is advertising aimed at increasing the demand for all brands of a product within a specific industry. Trade and industry associations, such as the National Pork Producers Council and the California Milk Processor Board, use primary-demand advertising. To reach out to a new generation of potential home buyers, the National Association of Realtors launched a multimedia campaign, "That's Who We R," to highlight stories of professional realtors helping all kinds of families buy homes and start businesses.[16]

Selective-Demand Advertising **Selective-demand** (or **brand**) **advertising** is advertising that is used to sell a particular brand of product. It is by far the most common type of advertising, and it accounts for the majority of advertising expenditures. As an example, Burger King used radio ads to introduce its Impossible Whopper, humorously highlighting the confusion people experience eating a plant-based burger that tastes just like a Whopper made with beef.[17]

sales promotion the use of activities or materials as direct inducements to customers or salespersons

public relations communication activities used to create and maintain favorable relationships between an organization and various public groups, both internal and external

primary-demand advertising advertising whose purpose is to increase the demand for *all* brands of a product within a specific industry

selective-demand (or brand) advertising advertising that is used to sell a particular brand of product

ISTOCK.COM/ALESSANDRO BIASCIOLI

Harnessing the power of social media. Social media allows a business to reach out to customers in a context that is familiar and comfortable to them. Firms attempt to measure the effectiveness of their social media efforts by gathering statistics on the number of followers and fans they have, traffic to their websites, and mentions of their products on social networking sites.

Selective-demand advertising that aims at persuading consumers to make purchases within a short time is called *immediate-response advertising*. Most local advertising is of this type. Often local advertisers promote products with immediate appeal. Selective advertising aimed at keeping the public aware of a firm's name or product is called *reminder advertising*. *Comparative advertising* compares the sponsored brand with one or more identified competing brands. The association shows the sponsored brand to be as good as or better than the other identified competing brands. Marketers must be careful when using this technique to present information truthfully and not to obscure or distort facts.

Institutional Advertising **Institutional advertising** is advertising designed to enhance a firm's image or reputation. Some large firms allocate a portion of advertising dollars to build goodwill, rather than to stimulate sales directly. As an example, McDonald's ran commercials thanking healthcare workers, firefighters, and other first responders for their service during the COVID-19 pandemic. The fast-food chain also gave away "Thank You Meals" that included a thank you note to first responders.[18] A positive public image helps an organization to attract customers, employees, and investors.

13-8b Major Steps in Developing an Advertising Campaign

An advertising campaign is developed in several stages, which can vary in the order in which they are implemented. Factors affecting a campaign include the company's resources, products, and target audiences. The development of a campaign in any organization includes the following steps in some form:

1. Identify and Analyze the Target Audience The target audience is the group toward which a firm's advertisements are directed. To pinpoint the organization's target audience and develop an effective campaign, marketers analyze various factors, such as the geographic distribution of potential customers, their age, gender, race, income, and education, and their attitudes toward the product, the nature of the competition, and the product's features. It is crucial to identify the target market correctly because all subsequent efforts will fail if not directed at the right audience.

2. Define the Advertising Objectives The goals of an advertising campaign should be stated precisely and in quantifiable terms. Objectives should give specific details about the actual and desired position of the company and how it will arrive there, including a timetable for achieving goals. For example, advertising objectives that focus on sales will stress increasing sales by a certain percentage or dollar amount, or expanding the firm's market share by a specific amount.

3. Create the Advertising Platform An advertising platform includes the important selling points, or features, that an advertiser will incorporate into the advertising campaign. These should be features that are lacking in competitors' products and that are important to customers. Although research into what consumers view as important issues is expensive, it is the most productive way to determine what to include in an advertising platform.

4. Determine the Advertising Appropriation The advertising appropriation is the total amount of money designated for advertising in a given time period. Developing an acceptable advertising appropriation is critical—too little and promotional efforts will not meet demand, too much will waste resources and

institutional advertising
advertising designed to enhance a firm's image or reputation

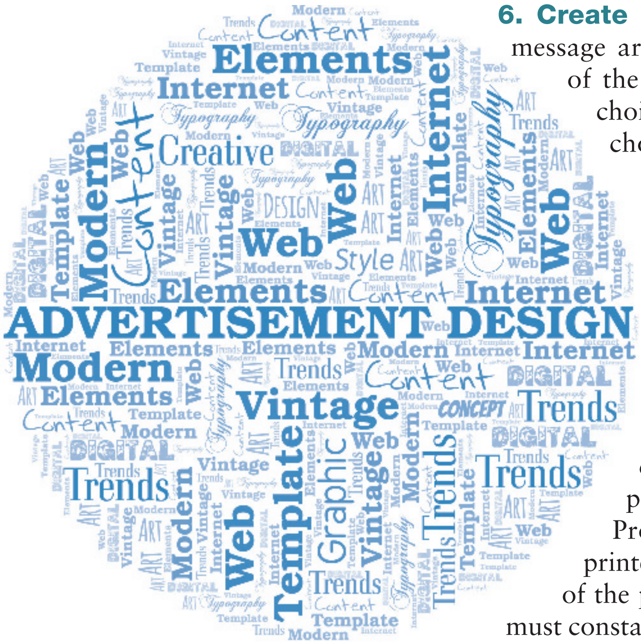
reduce the funds available for other activities. Advertising appropriations may be based on historical or forecasted sales, what competitors spend on advertising, or executive judgment. Companies that spend the most on advertising in the United States include Amazon, Procter & Gamble, L'Oréal, Samsung, and Unilever.[19]

5. Develop the Media Plan A media plan includes media selection and media scheduling. This involves deciding which media vehicles to use: internet and mobile, television, radio, out of home, magazines, newspapers, or some combination. Although cost-effectiveness is not easy to measure, the primary concern of the media planner is to reach the largest proportion of the target audience possible for each dollar spent. Media planners must also consider the location and demographics of the target market, the content of the message, and the characteristics of the audiences reached by various media. The media planner begins with general media decisions, selects subclasses within each medium, and chooses specific media vehicles for the campaign. The advantages and disadvantages of the major media classes are shown in Table 13-3.

Table 13-3 Advantages and Disadvantages of Major Media Classes

	Advantages	Disadvantages
Internet/Digital Media	Immediate response, potential to reach a precisely targeted audience, ability to track customers and build databases, highly interactive medium, real-time analytics	Costs of precise targeting can be high, inappropriate ad placement, effects difficult to measure, concerns about security and privacy
Social Media	Target, interact, and connect more personally with customers, receive real-time feedback, direct messages to specific individuals, effectively reach target market/followers	Restricted number of contacts per message because of highly targeted nature, new media—unsure of best applications and how to calculate ROI, large time commitment to monitor
Television	Reaches large audiences, high frequency available, dual impact of audio and video, highly visible, high prestige, geographic and demographic selectivity, difficult to ignore, on-demand capabilities	Very expensive, highly perishable message, size of audience not guaranteed, amount of prime time limited, lack of selectivity in target market
Radio	Reaches a large proportion of consumers, mobile and flexible, low relative costs, ad can be changed quickly, high level of geographic and demographic selectivity, encourages use of imagination	Lacks visual imagery, short life of message, listeners' attention limited, market fragmentation, difficult buying procedures, limited media and audience research
Out of Home	Allows for frequent repetition, low cost, message can be placed close to point of sale, geographic selectivity, operable 24 hours a day, high creativity	Message must be short and simple, no demographic selectivity, seldom attracts readers' full attention, criticized as traffic hazard and blight on landscape, much wasted coverage, limited capabilities
Magazines	Demographic selectivity, good reproduction, long life, prestige, geographic selectivity when regional issues available	High costs, 30- to 90-day average lead time, high level of competition, limited reach, communicates less frequently
Newspapers	Reaches large audience, purchased to be read, geographic flexibility, short lead time, frequent publication, favorable for cooperative advertising	Not selective for socioeconomic groups or target market, short life, limited reproduction capabilities, large advertising volume limits exposure
Direct Mail	Little wasted circulation, highly selective, circulation controlled by advertiser, few distractions, personal, stimulates actions, easy to measure performance, hidden from competitors	Very expensive, lacks editorial content to attract readers, often thrown away unread as junk mail, criticized as invasion of privacy, consumers must choose to read the ad

Sources: Adapted from William F. Arens and Michael Weigold, *Contemporary Advertising & Integrated Communications,* 16th ed. (Burr Ridge, IL: Irwin/McGraw-Hill, 2021); George E. Belch and Michael Belch, *Advertising and Promotion: An Integrated Marketing Communications Perspective,* 12th ed. (Burr Ridge, IL: Irwin/McGraw-Hill, 2021).



SHARAF MAKSUMOV/SHUTTERSTOCK.COM

6. Create the Advertising Message The content and form of a message are influenced by the product's features, the characteristics of the target audience, the objectives of the campaign, and the choice of media. An advertiser must consider these factors to choose words and illustrations that will be meaningful and appealing to the target audience. The copy, or words, of an advertisement will vary depending on the media choice, but attempt to engage the audience and move them through attention, interest, desire, and action. Artwork and visuals should complement copy by being visually attractive and communicating an idea quickly.

7. Execute the Campaign Execution of an advertising campaign requires extensive planning, scheduling, and coordinating because the tasks are carried out by many people and organizations and must be completed on time. Production companies, research organizations, media firms, printers, photoengravers, and commercial artists are just a few of the potential contributors to a campaign. Advertising managers must constantly assess the quality of the work and take corrective action when necessary. In some instances, advertisers must make changes in the middle of the campaign to meet objectives.

8. Evaluate Advertising Effectiveness A campaign's success should be compared against original objectives at regular intervals before, during, and after campaign launch. An advertiser should be able to track the impact of the campaign on sales and market share, as well as changes in customer attitudes and brand awareness. Data from past and current sales and responses to coupon offers and customer surveys administered by research organizations are some of the ways in which advertising effectiveness can be evaluated. Table 13-4 shows the five advertisers with the most effective campaigns according to the Effie Effectiveness Index, a global ranking system for advertising effectiveness. This ranking takes into account factors such as ROI, sales growth, and brand awareness in relation to money spent on promotional activities.

13-8c Advertising Agencies

Advertisers can plan and produce their own advertising with help from in-house media personnel, or they can hire advertising agencies. An **advertising agency** is an independent firm that plans, produces, and places advertising for clients. Many large

advertising agency an independent firm that plans, produces, and places advertising for its clients

Table 13-4 Most Effective Advertisers

Ranking	Advertiser
1	Unilever
2	Coca-Cola
3	Nestlé
4	AB InBev
5	PepsiCo

Source: Effie Worldwide, "2020 Effie Effectiveness Index: Overview," https://www.effieindex.com/ranking/overview.cfm (accessed March 8, 2021).

Exploring Careers

How to Land a Job in an Advertising Agency

Advertising, personal selling, sales promotion, and public relations are the four elements of the promotion mix. Advertising alone is a multibillion-dollar industry in the United States and offers exciting career opportunities. Instead of working for an individual company, many people seek employment at advertising agencies, independent firms that plan, produce, and place advertising for their clients. Some of the largest advertising agencies include BBDO, Deloitte Digital, Dentsu, Ogilvy, and TBWA Worldwide.

An early step toward starting a career in advertising is seeking a degree in a related field such as business, marketing, or communications. Some universities specifically offer a bachelor's degree in advertising that focuses on the principles of advertising, communication theory and analysis, creative strategy, media planning, ad sales, and more. Beyond college, one way to get a foot in the door of an agency is to apply for an internship. Internships provide valuable, hands-on experience in the fast-paced world of advertising. Many internships end with a job offer for an entry-level position.

Jobs in advertising include account coordination, copywriting, media buying, and more. To build a portfolio of work, freelancing can be an effective way to break into copywriting and graphic design in particular. In addition to traditional person-to-person networking, websites like Fiverr and Upwork can help individuals land clients. Even without engaging in freelancing, job seekers can hone their skills by creating spec ads by either reimagining existing print, digital, mobile, outdoor, or radio advertisements or conceptualizing an original campaign from the ground up. The important element is to show an understanding of the brand or product being promoted and demonstrate creativity and effective communication.

Though print advertising is in decline, the advertising industry as a whole is flourishing as companies invest in digital and mobile. Digital advertising will continue to grow at a greater rate than traditional media, accounting for more than 50 percent of ad spending. The changing landscape of advertising makes this career path both exciting and lucrative.

Sources: Based on information in Apryl Duncan, "How to Work for an Advertising Agency," *The Balance Careers*, January 4, 2020, www.thebalancecareers.com/getting-job-at-ad-agency-38627; "US Digital Ad Spending Will Surpass Traditional in 2019," *eMarketer*, February 19, 2019, www.emarketer.com/content/us-digital-ad-spending-will-surpass-traditional-in-2019; "How to Get Into Advertising: Step-by-Step Career Guide," *Masterclass*, November 8, 2020, www.masterclass.com/articles/how-to-get-into-advertising.

ad agencies also help with sales promotion and public relations. The cost of using an advertising agency can be moderate, especially for large campaigns. It is usually around 15 percent commission. Some firms opt to use a combination of in-house advertising talent and outside specialists.

13-8d **Social and Legal Considerations in Advertising**

Critics of U.S. advertising have two main complaints—that it is wasteful and that it can be deceptive. Although advertising (like any other activity) can be performed inefficiently, evidence shows that it is not wasteful:

- Advertising is the most effective and least expensive means of communicating product information to a large number of individuals and organizations.
- Advertising encourages competition. It thus leads to the development of new and improved products, wider product choices, and lower prices.
- Advertising revenues support mass-communication media—internet, television, newspapers, magazines, and radio, effectively paying for news coverage and entertainment programming.
- Advertising provides job opportunities in fields ranging from sales to film production.

✓ Concept Check

- Describe the major types of advertising by purpose.
- Explain the eight major steps in developing an advertising campaign.

A number of government and private agencies scrutinize advertising for false or misleading claims or offers that might harm consumers. At the national level, the Federal Trade Commission (FTC), the Food and Drug Administration (FDA), and the Federal Communications Commission (FCC) oversee advertising practices. Advertising also may be monitored by state and local agencies, better business bureaus, and industry associations.

13-9 Personal Selling

Learning Objective

13-9 Explore personal selling, including the types of salespersons, the personal-selling process, and major sales management tasks.

order getter a salesperson who is responsible for selling a firm's products to new customers and increasing sales to current customers

creative selling selling products to new customers and increasing sales to current customers

order taker a salesperson who handles repeat sales in ways that maintain positive relationships with customers

sales support personnel employees who aid in selling but are more involved in locating prospects, educating customers, building goodwill for the firm, and providing follow-up service

Personal selling is the most adaptable of all promotional methods because the person presenting the message can modify it to suit the individual buyer. However, it is also the most expensive method because it involves salespeople communicating with customers one at a time or in small groups. Many selling situations demand the face-to-face contact and adaptability of personal selling. This is especially true of industrial sales, in which a single purchase may amount to millions of dollars. Obviously, sales of that size must be based on carefully planned presentations, personal contact with customers, and thorough negotiations.

13-9a Kinds of Salespersons

Because most businesses employ different salespersons to perform different functions, marketing managers need to select the kinds of sales personnel that will be most effective in selling the firm's products. Salespersons may be identified as order getters, order takers, and support personnel. A single individual can, and often does, perform all three functions.

Order Getters An **order getter** is responsible for what is sometimes called **creative selling**—selling a firm's products to new customers and increasing sales to current customers. An order getter must be able to perceive buyers' needs, supply customers with information about the product, and persuade them to buy it.

ISTOCK.COM/KATE_SEPT2004

The pros and cons of personal selling. Personal selling is sometimes more effective than advertising. It's easy to ignore an advertisement. Saying "no" to a salesperson is much harder. The main drawback of personal selling is that it's expensive, which is why it's generally used to sell high-dollar goods and services.

Order Takers An **order taker** handles repeat sales and customer demands to maintain positive relationships. *Inside order takers* receive incoming mail, online, and telephone orders for businesses. Salespersons in retail stores are also inside order takers. *Outside* (or *field*) *order takers* travel to customers. Often the buyer and the field salesperson develop a mutually beneficial relationship of placing, receiving, and delivering orders. Both inside and outside order takers are active salespersons and produce a large proportion of their companies' sales.

Support Personnel **Sales support personnel** aid in selling but are more involved in locating prospects (likely first-time customers), educating customers, building goodwill for the firm, and providing follow-up service. The most common categories of support personnel are missionary, trade, and technical salespersons.

A **missionary salesperson**, who usually works for a manufacturer, visits retailers to persuade them to buy the manufacturer's products. If the retailers agree, they buy the products from wholesalers, who are the manufacturer's actual customers.

A **trade salesperson**, who generally works for a food producer or processor, assists customers in promoting products, especially in retail stores. A trade salesperson may obtain additional shelf space for the products, restock shelves, set up displays, and distribute samples. Because trade salespersons usually are order takers as well, they are not strictly support personnel.

A **technical salesperson** assists a company's current customers in technical matters. Technical salespeople may explain how to use a product, how it is made, how to install it, or how a system is designed. They should have degrees in science or engineering.

Firms usually need to employ sales personnel from several of these categories. Factors that affect which sales personnel are hired include the number of customers and their characteristics; the product's attributes, complexity, and price; the distribution channels used by the company; and the company's approach to advertising.

13-9b The Personal-Selling Process

No two selling situations are exactly alike, and no two salespeople perform their jobs in exactly the same way. Most salespeople, however, follow the six-step procedure illustrated in Figure 13-3.

Prospecting The first step in personal selling is to research potential buyers and choose the most likely customers, or prospects. Business associates and customers, social media contacts, public records, telephone and trade-association directories, and company files can all be good sources of new prospects. The salesperson also assesses whether prospects have the financial resources, willingness, and authority to buy the product, a process known as *qualifying*.

Approaching the Prospect First impressions are often lasting. Therefore, a salesperson's first contact with a prospect is crucial to successful selling. A salesperson should be friendly and knowledgeable about the product, the prospect's needs, and how the product can meet those needs. Those salespeople who demonstrate an understanding of and sensitivity to a customer's situation are more likely to make a good first impression and make a sale.

Making the Presentation The next step is actual delivery of the sales presentation, which often includes a product demonstration. The salesperson points out the product's features, its benefits, and how it is superior to competitors' merchandise. The salesperson may list other clients (if given permission) during the presentation.

During a demonstration, the salesperson may suggest that the prospect try out the product personally. The demonstration and product trial should underscore specific points made during the presentation.

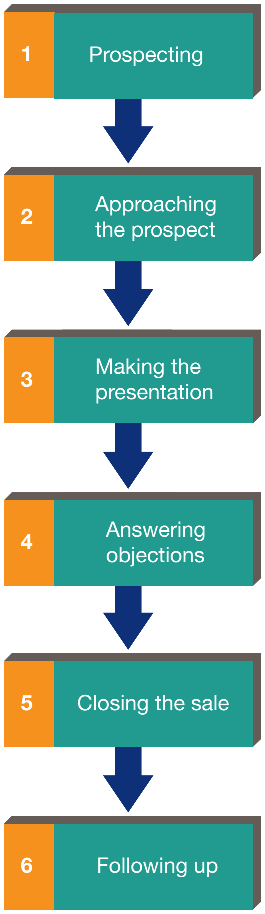
Answering Objections The prospect may raise objections or ask questions at any time during the process. This is the salesperson's chance to eliminate objections that could prevent a sale, to point out additional features, or to mention special services the company offers.

Closing the Sale To close the sale, the salesperson asks the prospect to buy the product. This is the critical point in the selling process. Many experienced salespeople employ a *trial closing,* in which they ask questions before the actual close in a tone that assumes a successful sale. Typical questions are: "When would you want delivery?" and "Do you want the standard model or the one with the special options package?" They allow the salesperson to gauge the likelihood and imminence of a sale.

Following Up The salesperson's job does not end with a sale. They must follow up to ensure that the product is delivered on time, in the right quantity, and in proper

Figure 13-3 **The Six Steps of the Personal-Selling Process**

Personal selling is not only the most adaptable of all promotional methods but also the most expensive.



missionary salesperson a salesperson—generally employed by a manufacturer—who visits retailers to persuade them to buy the manufacturer's products

trade salesperson a salesperson—generally employed by a food producer or processor—who assists customers in promoting products, especially in retail stores

technical salesperson a salesperson who assists a company's current customers in technical matters operating condition. During follow-up, salespeople should also make it clear that they are available in case problems develop. Follow-up is essential to the selling process because it leaves a good impression and helps to increase the likelihood of future sales.

13-9c **Major Sales Management Tasks**

A firm's success often hinges on the competent management of its sales force. Although some companies operate efficiently without one, most firms rely on a strong sales force—and the revenue it brings in—for their success.

Sales managers must:

- Set sales objectives in concrete, quantifiable terms and specify a period of time and geographic area;
- Adjust the size of the sales force to meet changes in the firm's marketing plan and the marketing environment;
- Attract and hire effective salespersons;
- Develop a training program and decide where, when, how, and for whom to conduct the training;
- Formulate a fair and adequate compensation plan to retain qualified employees;
- Motivate salespersons to keep their productivity high;
- Define sales territories and determine scheduling and routing of the sales force; and
- Evaluate the operation holistically, through sales reports, communications with customers, and invoices.

✓ Concept Check

- What are the advantages and disadvantages of using personal selling?
- Identify the three types of salespersons.
- Describe the six steps of the personal-selling process.

13-10 Sales Promotion

Learning Objective

13-10 Identify sales promotion objectives and methods.

Sales promotion consists of activities or materials that are direct inducements to customers or salespersons. Receiving a free sample at the supermarket or using a frequent flier program are examples of sales promotions. Sales promotion techniques can significantly affect sales and are often used to enhance and supplement other promotional methods. Firms have dramatically increased spending on sales promotions as they increase their importance as part of the promotion mix.

13-10a **Sales Promotion Objectives**

Sales promotion activities may be used singly or in combination to achieve one goal or a set of goals. Marketers use sales promotion activities and materials for a number of purposes, including:

1. To attract new customers;
2. To encourage trial of a new product;
3. To invigorate the sales of a mature brand;
4. To boost sales to current customers;
5. To reinforce advertising;
6. To increase traffic in retail stores;
7. To smooth out customer demand;
8. To build up reseller inventories;
9. To neutralize the competition's promotional efforts; and
10. To increase the attractiveness of shelf placement and displays.

Sales promotion objectives should be consistent with the organization's general goals and with its marketing and promotional objectives.

13-10b **Sales Promotion Methods**

ISTOCK.COM/CASPER1774STUDIO

Do you use coupons? Companies give away coupons to increase the sales of their products and encourage consumers who are unfamiliar with their products to give them a try.

Most sales promotion methods can be classified as promotional techniques for either consumer sales or trade sales.

A **consumer sales promotion method** attracts consumers to particular retail stores and motivates them to purchase certain new or established products. A **trade sales promotion method** encourages wholesalers and retailers to stock and actively promote a manufacturer's product. Incentives such as money, merchandise, marketing assistance, and gifts may provide incentives to resellers to purchase products or support a firm in other ways. Of the combined dollars spent on sales promotion and advertising, about one-half is spent on trade promotions, one-fourth on consumer promotions, and one-fourth on advertising.

Rebates A **rebate** is a return of part of the purchase price of a product. Usually the rebate is offered by the producer to consumers who submit proof of purchase and perhaps other documents. Rebating is a relatively low-cost promotional method, but consumers may not be attracted by it because they view it to be too complicated or time consuming.

Coupons A **coupon** reduces the retail price of a particular item by a stated amount at the time of purchase. Coupons may be worth anywhere from a few cents to a few dollars. Customers can find coupons online, through apps, and in newspapers, magazines, direct mail, and shelf dispensers in stores. After declining throughout the 1990s, the popularity of coupons has rebounded, largely because consumers can visit coupon websites, and companies send coupons via email or smartphone to loyal customers. Target, for instance, offers customers customized coupons and more via its Target app. RetailMeNot gives consumers access to digital coupon offers and promo codes from 70,000 stores and restaurants via a website or smartphone app.[20]

Samples A **sample** is a free product given to customers to encourage trial and purchase. Marketers utilize samples to increase awareness of a product, which can increase sales volume in the early stages of a product's life cycle and improve distribution. Samples may be offered via online coupons or direct mail or in stores. It is the most expensive sales promotion technique. Established brands, such as cosmetics companies, may use free samples to attract customers and renew interest in a brand. Club Demonstration Services, which operates sampling tables for Costco, reported that its sampling of a frozen pizza product at many retailers boosted sales by an average of 600 percent.[21] Organizations must consider such factors as seasonal demand for the product, market characteristics, and prior advertising when designing a free sample campaign.

Premiums A **premium** is a gift that a producer offers a customer in return for buying its product. It is used to attract competitors' customers, introduce different sizes of established products, add variety to other promotional efforts, and stimulate consumer loyalty. Creativity is essential when using premiums. To stand out and achieve a significant number of redemptions, the premium must suit the target audience and the brand's image. The premium must also be recognizable and desirable to customers. Premiums are generally placed on or inside packages.

Frequent-User Incentives A **frequent-user incentive** is a program developed to reward customers who engage in repeat (frequent) purchases. These are often called customer loyalty programs, and increasingly, they are app-based. Such programs are used commonly by service businesses such as airlines, hotels, auto

consumer sales promotion method a sales promotion method designed to attract consumers to particular retail stores and to motivate them to purchase certain new or established products

trade sales promotion method a sales promotion method designed to encourage wholesalers and retailers to stock and actively promote a manufacturer's product

rebate a return of part of the purchase price of a product

coupon reduces the retail price of a particular item by a stated amount at the time of purchase

sample a free product given to customers to encourage trial and purchase

premium a gift that a producer offers a customer in return for buying its product

frequent-user incentive a program developed to reward customers who engage in repeat (frequent) purchases

point-of-purchase display promotional material placed within a retail store

trade show an industry-wide exhibit at which many sellers display their products

buying allowance a temporary price reduction to resellers for purchasing specified quantities of a product

cooperative advertising an arrangement whereby a manufacturer agrees to pay a certain amount of a retailer's media cost for advertising the manufacturer's products

rental agencies, and coffee shops. Frequent-user incentives foster customer loyalty because the customer is given an additional reason to continue patronizing the company or group of companies. A well-structured program can also generate significant data about customer usage and preferences that companies can use to refine their marketing strategies.

Point-of-Purchase Displays A **point-of-purchase display** is promotional material placed within a retail store. The display is usually located near the product being promoted. It may hold merchandise or information and encouragements to buy the product. Most point-of-purchase displays are prepared and set up by manufacturers and wholesalers.

Trade Shows A **trade show** is an industry-wide exhibit at which many sellers display their products. Many trade shows are organized exclusively for dealers—to permit manufacturers and wholesalers to show their latest lines to retailers. Others are promotions designed to stimulate consumer awareness and interest, such as annual home or bridal shows.

Buying Allowances A **buying allowance** is a temporary price reduction to resellers for purchasing specified quantities of a product. A laundry detergent manufacturer might give retailers $1 for each case of detergent purchased. A buying allowance is an incentive to resellers to handle new products and may stimulate purchase of items in large quantities. A shortcoming of buying allowances is that competitors can counter quickly with their own buying allowances.

Cooperative Advertising **Cooperative advertising** is an arrangement whereby a manufacturer agrees to pay a certain amount of a retailer's media cost for advertising the manufacturer's products. To be reimbursed, a retailer must show proof that the advertisements did appear. Not all retailers take advantage of available cooperative advertising offers, either because they cannot afford to advertise or choose not to.

✓ Concept Check

- Why do marketers use sales promotion?
- What are the two classifications of sales promotion methods?
- What factors affect the choice of sales promotion used?

13-10c Selection of Sales Promotion Methods

Several factors affect a marketer's choice of sales promotion methods, including:

1. The objectives of the promotional effort;
2. Product characteristics—size, weight, cost, durability, uses, features, and hazards;
3. Target-market profiles—age, gender, income, location, density, usage rate, and buying patterns;
4. Distribution channels and availability of appropriate resellers; and
5. The competitive and regulatory forces in the environment.

13-11 Public Relations

Learning Objective

13-11 Describe the types and uses of public relations.

As noted earlier, public relations is a broad set of communication activities used to create and maintain favorable relationships between an organization and various public groups, both internal and external. These groups may include customers, employees, stockholders, suppliers, educators, the media, government officials, and society in general.

13-11a Types of Public Relations Tools

Organizations use a variety of public relations tools to convey messages and to create images. Public relations professionals prepare written materials such as brochures,

Entrepreneurial Success

Inside BODEN, an Award-Winning, Latina-Owned PR Company

BODEN is an independent communications agency in Miami, Florida, which was founded by Honduran native Natalie Boden. Boden has received numerous accolades for her agency's successes, including being inducted into PRWeek's "Hall of Femme." She also serves on the board of directors for the Culture Marketing Council.

Boden started with a single client, the Miami Parking Authority. After building a small set of retainer clients (clients who pay a fee in advance for services over an extended period of time), Boden hired her first employee. Not long after, the agency landed its first Fortune 500 clients, Target and McDonald's. The company has been recognized by the Hispanic Public Relations Association as "PR Agency of the Year" and by PR News as being one of the "Best Places to Work."

Boden says that her public relations agency's competitive advantage is its independence. BODEN can offer the creativity and quick turnaround of a boutique agency while upholding the standards of a global agency. The agency, which includes communicators, strategists, creatives, and digital and social experts, focuses on building trust with multicultural and Hispanic communities. Rather than turning to paid media (i.e., advertising), BODEN's approach centers around earned media (i.e., public relations). The PR agency has built relationships with influencers, organizations, community leaders, and the media to generate publicity.

Boden discourages her clients from using clichéd tactics such as hiring Hispanic celebrities or developing a Spanish advertisement. To stand out to Hispanic audiences, BODEN's mission is to "help global brands lead with culture." This means standing out with bold, culturally strategic communications that are both authentic and inspiring. The agency stands behind long-term, purpose-driven strategies that will leave a legacy.

Sources: Based on information in Court Stroud, "How One Latina Entrepreneur Founded an Award-Winning, Female-Led PR Company," *Forbes*, April 29, 2020, www.forbes.com/sites/courtstroud/2020/04/29/how-one-latina-entrepreneur-founded-an-award-winning-female-led-pr-company; Steve Barrett, "Cafecito Break with Boden PR's Natalie Boden," *PR Week*, October 14, 2020, www.prweek.com/article/1697276/cafecito-break-boden-prs-natalie-boden; BODEN, "About Us," https://www.bodenagency.com/about.

newsletters, company magazines, annual reports, and news releases. They also create corporate-identity materials such as logos, business cards, signs, and stationery. Speeches, YouTube videos, and social media accounts at TikTok, Twitter, Instagram, and Facebook are additional public-relations tools through which companies can communicate information and ideas, interact with customers and other brands, or respond to negative information about the firm. Consider the San Diego Zoo, which has nearly 2 million followers on TikTok and uses the platform to post humorous animal videos that keep the nonprofit organization on the public's mind.[22]

GRINDSTONE MEDIA GROUP/SHUTTERSTOCK.COM

Event sponsorships are intended to promote a positive image of a firm. Event sponsorships are a public relations tool. They are often used in conjunction with advertising, personal selling, and sales promotions.

Another public relations tool is event sponsorship, in which a company pays for all or part of a special event such as a concert, sports competition, festival, or play. Sponsoring special events is an effective way for organizations to increase brand recognition and receive media coverage, sometimes with relatively little investment. The energy drink brand Red Bull, for example, underscores its reputation for giving consumers energy through sponsoring athletes and teams, acts of daring, concerts, and festivals such as Coachella.

Publicity is an important part of public relations, as it increases public awareness of a firm or brand through mass media communications at no cost to the business. **Publicity** is communication in news-story form about an organization, its products, or both. Organizations use publicity to provide information about products; to

publicity communication in news-story form about an organization, its products, or both

news release a typed page of about 300 words provided by an organization to the media as a form of publicity

feature article a piece (of up to 3,000 words) prepared by an organization for inclusion in a particular publication

captioned photograph a picture accompanied by a brief explanation

press conference a meeting at which invited media personnel hear important news announcements and receive supplementary textual materials and photographs

announce new product launches, expansions, or research; and to strengthen the company's image. Public relations personnel sometimes organize events, such as grand openings with prizes and celebrities, to generate news coverage of a company.

The most widely used tool of publicity is the **news release**. It is generally one typed page of about 300 words provided by an organization to the media as a form of publicity. The release includes the firm's name, address, phone number, and contact person. A **feature article**, which may run as long as 3,000 words, is usually written for inclusion in a particular publication. For example, a software firm might send an article about its new product to a computer magazine. A **captioned photograph**, a picture accompanied by a brief explanation, is an effective way to illustrate a new or improved product. A **press conference** allows invited media personnel to hear important news announcements and to receive supplementary materials and photographs. Finally, letters to the editor, special newspaper or magazine editorials, and videos may be prepared and distributed to appropriate media for possible use in news stories.

13-11b Uses of Public Relations

Public relations can be used to promote many things, including people, places, activities, and ideas. Public relations focuses on enhancing the reputation of the total organization by increasing public awareness of a company's products, brands, or activities and by fostering desirable company images, such as that of innovativeness, dependability, or social responsibility. By getting the media to report on a firm's accomplishments, public relations helps a company to maintain public visibility. Effective management of public relations efforts also can reduce the amount of unfavorable coverage surrounding negative events. For example, after KFC UK suffered negative publicity when it was unable to receive chicken supplies due to a delivery snafu, the company launched a mischievous campaign that included full-page ads and irreverent tweets to apologize and update British customers in a humorous way on when restaurants would resume normal operations.[23]

✓ Concept Check

- What are the common tools of public relations?
- What is publicity, and why do organizations use it?
- What are the four common types of publicity?

Summary

13-1 Examine the various distribution channels and market coverage of products.

A marketing channel is a sequence of marketing organizations that directs a product from producer to ultimate user. The marketing channel for a particular product is concerned with the transfer of ownership of that product.

The channels used for consumer products include the direct channel from producer to consumer, the channel from producer to retailer to consumer, the channel from producer to wholesaler to retailer to consumer, and the channel from producer to agent to wholesaler to retailer to consumer. There are two major channels of industrial products: producer to user and producer to agent middleman to user. Firms often use multichannel distribution that includes more than one channel. Products may also be distributed digitally via the internet.

Channels and intermediaries are chosen to implement a given level of market coverage. Intensive distribution is the use of all available outlets for a product, providing the widest market coverage. Selective distribution uses a portion of the available outlets in an area. Exclusive distribution uses only a single retail outlet for a product in a large geographic area.

13-2 Explain how supply chain management facilitates partnering among channel members.

Supply chain management refers to the coordination of all marketing channel activities associated with the flow and transformation of supplies, products, and information throughout the supply chain to the ultimate consumer. Cooperation is required among all channel members, including manufacturing, research, sales, advertising, and shipping. When all channel partners work together, delivery, scheduling, packaging, and other customer requirements are better met. Technology makes supply chain management easier to implement.

13-3 Describe the types of wholesalers and the services they provide.

Wholesalers—intermediaries that purchase from producers or other intermediaries and sell to industrial users, retailers, or other wholesalers—increase distribution efficiency. They perform many functions in a distribution channel. If they are eliminated, other channel members—such as the producer or retailers—will have to perform these functions. Wholesalers help retailers with promoting products, collecting information, and financing. They help manufacturers with sales assistance, reduce their inventory costs, furnish market information, and extend credit to retailers.

Wholesalers may be classified as merchant wholesalers, agents, or brokers, depending in part on whether they take title to merchandise. Merchant wholesalers buy and then sell products to other intermediaries. Agents and brokers expedite exchanges, represent a buyer or a seller, and may be hired permanently (agents) or temporarily (brokers) on a commission basis. Sales branches and offices are owned by the manufacturers and resemble merchant wholesalers and agents, respectively.

13-4 Distinguish among the major types of retailers and shopping centers.

Retailers are intermediaries that buy from producers or wholesalers and sell to consumers. Online retailing makes products available to buyers through computer or mobile connections. Multichannel retailing, which uses multiple types of retailing, is growing rapidly. In-store retailers include department stores, discount stores, warehouse showrooms, convenience stores, supermarkets, superstores, warehouse clubs, traditional specialty stores, off-price retailers, and category killers. Shopping centers can be classified into lifestyle, neighborhood, community, and regional, depending on their mix of stores and geographic area served. Nonstore retailers use direct selling, direct marketing, and vending. Types of direct marketing include online retailing, catalog marketing, direct-response marketing, telemarketing, and television home shopping.

13-5 Identify the five most important logistics activities.

Logistics, or physical distribution, consists of activities designed to move products from producers to ultimate users. Its five major functions are inventory management, order processing, warehousing, materials handling, and transportation. These interrelated functions are integrated into marketing efforts.

13-6 Define integrated marketing communications.

Integrated marketing communications is the coordination of promotion efforts to achieve maximum informational and persuasive impact on customers.

13-7 List the basic elements of the promotion mix.

Promotion is communication about an organization and its products that is intended to inform, persuade, or remind target market members. A promotion mix is the particular combination of promotion methods a firm uses to reach a target market—advertising, personal selling, sales promotion, and public relations. Organizations can use a push or pull strategy to promote their products.

13-8 Examine advertising, including types of advertising, the advertising campaign, and social and legal considerations.

Advertising is a paid nonpersonal message communicated to a specific audience through a mass medium. Primary-demand advertising promotes the products of an entire industry rather than just a single brand. Selective-demand advertising promotes a particular brand of product. Institutional advertising is image-building advertising for a firm.

An advertising campaign is developed in several stages. A firm first identifies and analyzes its advertising target. The goals of the campaign must be clearly defined. Then the firm develops the advertising platform and determines the size of advertising budget. The next steps are to develop a media plan, to create the advertising message, and to execute the campaign. Finally, promotion managers must evaluate the effectiveness of the advertising efforts before, during, and/or after the campaign. Although a firm can develop its own campaign, many firms employ advertising agencies to do so.

13-9 Explore personal selling, including the types of salespersons, the personal-selling process, and major sales management tasks.

Personal selling is personal communication aimed at informing customers and persuading them to buy a firm's products. It is the most adaptable promotional method because the salesperson can modify the message to fit individual buyers. The major types of salespersons are order getters, order takers, and support personnel. The six steps in the personal-selling process are prospecting, approaching the prospect, making the presentation, answering objections, closing the sale, and following up. Sales managers are involved directly in setting sales force objectives; recruiting, selecting, and training salespersons; compensating and motivating sales personnel; creating sales territories; and evaluating sales performance.

13-10 Identify sales promotion objectives and methods.

Sales promotion is the use of activities and materials as direct inducements to customers and salespersons. Sales promotions for consumers and business customers enhance and supplement other promotional methods. Methods of sales promotion include rebates, coupons, samples, premiums, frequent-user incentives, point-of-purchase displays, trade shows, buying allowances, and cooperative advertising.

13-11 Describe the types and uses of public relations.

Public relations is a broad set of communication activities used to create and maintain favorable relationships between an organization and various public groups, both internal and external. Organizations use a variety of public relations tools to convey messages and create images. Brochures, newsletters, company magazines, and annual reports are written public relations tools. Speeches, event sponsorship, and publicity are other public relations tools. Publicity is communication in news-story form about an organization, its products, or both. Types of publicity include news releases, feature articles, captioned photographs, and press conferences. Public relations can also be used to promote people, places, activities, and ideas. It can be used to enhance the reputation of an organization and reduce the unfavorable effects of negative events.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

distribution channel (or marketing channel) (365)
middleman (or marketing intermediary) (365)
retailer (366)
wholesaler (366)
multichannel (or omnichannel) distribution (366)
digital distribution (366)
intensive distribution (367)
selective distribution (367)
exclusive distribution (367)
supply chain management (367)
merchant wholesaler (369)
full-service wholesaler (369)
general-merchandise wholesaler (370)
limited-line wholesaler (370)
specialty wholesaler (370)
agent (370)
broker (370)
online retailing (370)
multichannel retailing (371)
independent retailer (371)
chain retailer (371)
department store (372)
discount store (372)
warehouse showroom (372)
convenience store (372)
supermarket (372)
superstore (372)
warehouse club (373)
traditional specialty store (373)
off-price retailer (373)
category killer (373)
lifestyle shopping center (374)
neighborhood shopping center (374)
community shopping center (374)
regional shopping center (374)
nonstore retailing (374)
direct selling (375)
direct marketing (375)
catalog marketing (375)
direct-response marketing (375)
telemarketing (375)
television home shopping (375)
vending (376)
logistics (376)
inventory management (377)
order processing (377)
warehousing (377)
materials handling (378)
transportation (378)
carrier (378)
integrated marketing communications (379)
promotion (380)
promotion mix (380)
advertising (380)
personal selling (380)
sales promotion (381)
public relations (381)
primary-demand advertising (381)
selective-demand (or brand) advertising (381)
institutional advertising (382)
advertising agency (384)
order getter (386)
creative selling (386)
order taker (386)
sales support personnel (386)
missionary salesperson (386)
trade salesperson (387)
technical salesperson (387)
consumer sales promotion method (389)
trade sales promotion method (389)
rebate (389)
coupon (389)
sample (389)
premium (390)
frequent-user incentive (390)
point-of-purchase display (390)
trade show (390)
buying allowance (390)
cooperative advertising (390)
publicity (391)
news release (392)
feature article (392)
captioned photograph (392)
press conference (392)

Discussion Questions

1. What are the most common marketing channels for consumer products? For industrial products?
2. What are the levels of market coverage? What types of products are each used for?
3. What services are performed by wholesalers for producers and for retailers?
4. Identify three kinds of full-service wholesalers. What factors are used to classify wholesalers into one of these categories?
5. Differentiate among the types of retailers.
6. What can nonstore retailers offer their customers that in-store retailers cannot?
7. What is logistics? Which major functions does it include?
8. Can a middleman be eliminated from a marketing channel? Explain.
9. What is integrated marketing communications, and why is it becoming increasingly accepted?
10. Identify and describe the major ingredients of a promotion mix.
11. Identify and give examples of the three major types of salespersons.
12. What are the major tasks involved in managing a sales force?
13. What is the difference between publicity and public relations? What is the purpose of each?
14. Why do firms use event sponsorship?

Case 13

Casper Thinks Inside the Box

Known for its “bed-in-a-box” concept, Casper Sleep Inc. was created in 2014 with the simple idea of selling a mattress online. The company’s goal was to create an affordable foam mattress that could be shipped in a box.

The direct-to-consumer (D2C) mattress company wanted to bypass traditional mattress showrooms and deliver mattresses direct to its customer's doors.

Investors initially turned their nose up at Casper's concept. They thought no one would ever purchase a mattress online and didn't see a path for Casper to disrupt the $14 billion mattress market. The founders charged tens of thousands of dollars to their credit cards to bring the brand to life. Eventually, they caught the eye of an investor who had experience with other D2C brands. When Casper launched, it sold out of inventory on day one. The company expected to make $1.8 million in its first year, but it ended up hitting that goal within two months. The online mattress market is now crowded with competitors such as Leesa, Purple, and Tuft & Needle.

Excitement around the brand ramped up quickly, attracting the attention of celebrity investors such as actor Ashton Kutcher and rapper Nas. Casper became known for its quirky advertising, such as puzzles on subway ads, but its social media mentions, both paid and organic, became the company's bread and butter. Happy customers were excited to spread the word about Casper online. Casper implemented a referral program to capitalize on this word-of-mouth communication. The program took off, leading to a wave of unboxing videos on YouTube.

The popular mattress brand has run into its fair share of challenges. The company was initially considered a "unicorn" leading up to its initial public offering (IPO), meaning the privately held company was valued at more than $1 billion. This made Casper seem like a good investment, but things took a turn when Casper reduced its IPO price from $17 to $12. Shortly after the IPO, investors filed a lawsuit against the company for allegedly misleading them and not disclosing material information prior to the IPO. While Casper's revenue was up, so were losses. Additionally, the company spent more than $400 million in less than three years on marketing alone to maintain its edge over the competition. The bigger issue was that Casper was worth much less than $1 billion.

Some say Casper intentionally mislead investors, reporting steadily increasing profits when the reality was more dismal. Additionally, although Casper's registration statement detailed growth efforts with the introduction of retail stores in 20 countries, the company stated shortly after the IPO that it would reduce the size of its global operations and wind-down its European operations. This led to a reduction of its workforce by 21 percent. Lastly, Casper also failed to disclose that it was unloading large amounts of old inventory to customers at steep discounts.

Despite these challenges, the CEO and co-founder of Casper, Philip Krim, continues to be enthusiastic about the company's future. Krim says that by opening more stores and initiating more retail partnerships, the company could spend less on sales and marketing.[24]

Questions

1. How does Casper's distribution strategy differ from traditional mattress companies?
2. Casper disrupted the mattress industry. Why do you think investors were initially hesitant to back Casper?
3. Describe Casper's promotion mix.

Building Skills for Career Success

1. Social Media Exercise

Social media allows brands to share their personalities and culture as well as their products with others. Some brands are more successful than others at this. Wendy's has gained a reputation on Twitter for not only promoting its products and interacting with its followers but also savagely roasting its competitors, especially McDonald's. It has also poked fun at other brands on #NationalRoastDay. The fast-food giant has established a presence on other social media platforms, including Animal Crossing, via Twitch. Find Wendy's Twitter page or search for the company in your favorite social media platform.

1. Do you think that social media buzz is an effective way to promote a product? Why or why not?
2. Have you ever interacted with a brand's social media campaign like Wendy's roasts of its competitors? If so, how did your interaction influence your feelings about the brand?

2. Building Team Skills

Surveys are a common tool in marketing research. The information they provide can reduce business risk and facilitate decision making. Retail outlets often survey their customers' wants and needs by distributing comment cards or questionnaires.

The following is an example of a customer survey that a local photography shop might distribute to its customers.

Assignment

1. Working in teams of three to five, choose a local retailer.
2. Classify the retailer according to the major types.
3. Design a survey to help the retailer improve customer service. (You may find it beneficial to work with the retailer and actually administer the survey to customers. Prepare a report of the survey results.)
4. Present your findings to the class.

Customer Survey

To help us to serve you better, please take a few minutes to answer the following questions. Your opinions are important to us.

1. Do you live/work in the area? (Circle one or both if they apply.)
2. Why did you choose us? (Circle all that apply.)
    - Close to home
    - Close to work
    - Convenience
    - Good service
    - Quality
    - Full-service photography shop
    - Other
3. How did you learn about us? (Circle one.)
    - Newspaper
    - Flyer/coupon
    - Passing by
    - Recommended by someone
    - Other
4. How frequently do you have photos printed? (Please estimate.)
    - ___ Times per month
    - ___ Times per year
5. Which aspects of our photography shop do you think need improvement?
6. Our operating hours are from 8:00 a.m. to 7:00 p.m. weekdays and from 9:30 a.m. to 6:00 p.m. Saturdays. We are closed on Sundays and legal holidays. If changes in our operating hours would serve you better, please specify your preferences.
7. Age (Circle one.)
    - Under 25
    - 25–39
    - 40–60
    - Over 60

Comments:

3. Researching Different Careers

When you are looking for a job, the people closest to you can be a great resource. Family members and friends may be able to answer your questions directly or put you in touch with someone else who can. This type of "networking" can lead to an "informational interview," in which you meet with someone who will answer your questions about a career or a company and who can provide inside information on related fields and other helpful hints.

Assignment

1. Choose a retailer or wholesaler and identify a position within the company that interests you.
2. Call the company and ask to speak to the person in that particular position. Explain that you are a college student interested in the position and ask to set up an informational interview.
3. Prepare a list of questions to ask in the interview. The questions should focus on:
    - a. The training and experience recommended for the position
    - b. How the person entered the position and advanced within the organization
    - c. What the person likes and dislikes about the work
    - d. Present your findings to the class

Running a Business

Part 5

Graeter's Is "Synonymous with Ice Cream"

When a 150-year-old company finally redesigns its logo and launches its first national ad campaign, that's big news. Graeter's, the beloved Cincinnati-based maker of premium, hand-packed ice cream, is still managed by direct descendants of its founders. Its new logo is just one part of a major rebranding effort to support the company's first big planned expansion. "If we don't continue to improve and innovate, somebody will come and do it better than us," says Chip Graeter, the company's vice president of retail stores. "And we don't want that to happen."

Quality Builds the Brand

Graeter's considers as its competitors not only the Häagen-Dazs and Ben & Jerry's brands, national premium ice-cream brands that have much bigger marketing budgets, but also all kinds of premium-quality desserts and edible treats. Taking that wide-angle view means its competition is both broad and fierce. One thing the company is firm about, however, is maintaining the quality of its dense, creamy product (it's so dense that one pint of Graeter's ice cream weighs about a pound). Graeter's quality standards call for adhering to its simple, original family recipe—which now includes more all-natural ingredients, like beet juice instead of food dye and dairy products from hormone-free cows—and an original, artisanal production process that yields only about two gallons per machine every 20 minutes. "We were always all-natural," says CEO Richard Graeter II, "but now we're being militant about it."

That hard-earned premium quality is what built the Graeter's brand from its earliest days when refrigeration was unknown and ice cream was a true novelty. Today, "Graeter's in Cincinnati is synonymous with ice cream," says a company executive. "People will say, 'Let's go get a Graeter's.' They don't say, 'Let's go get an ice cream.'" Quality is also what the current management team hopes will propel Graeter's beyond its current market, which consists of 55 company-owned retail stores in Ohio, Missouri, Kentucky, and nearby states, and the freezer cases of about 6,000 supermarkets and grocery stores, particularly the Kroger chain. Graeter's is also on the menu in some fine restaurants and country clubs. The company operates an online store and will ship ice cream overnight via UPS to any of the 48 continental states (California is its biggest shipping market). Graeter's also sells a limited line of candies, cakes, and other bakery goods, and its ice-cream line includes smoothies and sorbets.

Expanding to New Markets

Graeter's ambitious expansion plans are backed by a recent increase in production capacity from one factory to three (one of the new factories was built, and the other purchased). The plans call for distributing Graeter's delectable, seasonal flavors to even more supermarkets and grocery stores, and for gradually opening new retail stores, perhaps as far away as Los Angeles and New York. The Kroger chain is Graeter's biggest distribution partner. Of the tens of thousands of brands Kroger carries, says the chain, pricey Graeter's commands the strongest brand loyalty. It was through Kroger, in fact, that Graeter's managers hit upon the idea of conducting a trial expansion to Denver, a new market for the brand.

Kroger owns the King Soopers chain of grocery stores in Denver, and research showed that more Denver ice-cream buyers choose premium brands than cheaper choices, suggesting that Graeter's might do well there. So Graeter's chose 12 flavors to send to 30 King Soopers stores in Denver as a test market, with the goal of selling two or three gallons a week. The test was an unqualified success. Within a few weeks, the company was selling an average of five gallons a week per store.

"I'd like to be coast to coast," admits Graeter's CEO. In fact, the management team would like to explore selling Graeter's in Canada, perhaps within the next five years. "The challenge, of course, is to preserve the integrity of the product as we grow. But we have done that for more than 100 years, and I'd argue that it's better now than ever."

Promoting the Brand

Graeter's had already gotten a big free boost from a positive mention on the *Oprah Winfrey Show*, when the influential talk-show host called it the best ice cream she had ever tasted. "We were shipping about 40 orders a day," says CEO Richard Graeter II. "After her show, the next day we probably shipped 400." National attention continues with occasional exposure on the Food Network, the Travel Channel, and even the History Channel. "How does that happen?" asks one of the firm's executives. "It happens because we have a product and a process and a growth that is exciting."

Still, says George Denman, the company's vice president of sales and marketing, Graeter's faces the same challenge in new markets as any "small, regional niche player" and one with a limited marketing budget: "establishing a relationship with the consumer, building brand awareness [through] trial and repeat. . . . So obviously when we roll into a marketplace one of the first things we do is we sample the product. We get it out in front of the consumer and get them to taste it, because the product sells itself." The company has also been reducing its price to distributors, who pass the savings along to stores that can then advertise that Graeter's pints are on sale. "If a consumer has maybe been buying Ben & Jerry's and never considered ours, because maybe that dollar price point difference was too high, this gives her the opportunity to try us. And once she tries us, we know we've brand-switched that consumer right then," says Denman.

Marketing Communications

Through its Cincinnati-based ad agency, Graeter's does some local advertising, including attractive point-of-sale displays in supermarkets and grocery stores and some radio ads, occasional print ads, and billboards. The company launches small-scale promotions for the introduction of a new flavor or to celebrate National Ice Cream Month or other occasions. To support the brand's nationwide presence in grocery stores, the company began airing commercials nationally for the first time in 2014. The company has also received good publicity from its strategic partnerships with The Cure Starts Now Foundation and the Cincinnati Zoo. After the zoo had a baby hippo born premature, Graeter's introduced a new flavor called Chunky Hunky Hippo, with part of the revenue from the flavor going to help support the zoo and baby Fiona the hippo.

However, brand loyalty for this family business has grown mostly through word of mouth that endures across generations. "We are the beneficiary of that loyalty that our customers have built up over so many years, multiple generations," says one of the company's executives. "Our customers have told us they were introduced to the product through their grandmother, or a special time. . . . They don't come to our stores because they have to; they come because they want to."

"We use the traditional [marketing] methods," says Denman. "We are also doing nontraditional methods. We are looking at electronic couponing, where consumers will be able to go to our website as a new consumer . . . and secure a dollar-off coupon to try Graeter's, just for coming to our website or joining up on Facebook. We've done loyalty programs with Kroger where they have actually direct-mailed loyal consumers and offered . . . discounts as well. . . . So far it's worked well for us. We've had to go back and look at the return on investment on each of these programs and cut some things out and improve on some other things, but in the end we have been very pleased with the results."

"Quality . . . We Never Changed"

"We ship our product, and that was something that for the first hundred years you never thought about. I mean, who would think about shipping ice cream from Cincinnati to California? But it is our number-one market for shipping, so all those things you can change," says Richard Graeter, the CEO. "The most important thing, the quality of the product and how we make it, that we never changed."[25]

Questions

1. What are the elements of Graeter's marketing mix? Which are most likely to be affected by external forces in the marketing environment?
2. Graeter's ice-cream line includes smoothies and sorbets. Do you think it should consider other brand extensions such as yogurt, low-fat ice cream, coffee drinks, or other related products? Why or why not?
3. How might Graeter's capitalize on its valuable capacity for word-of-mouth promotion in expanding to new markets where, despite some national publicity from Oprah Winfrey, its name is still not widely known?

Building a Business Plan

Part 5

This part is one of the most important components of your business plan. In this part, you will present the facts that you have gathered on the size and nature of your market(s). State market size in dollars and units. How many units and what is the dollar value of the products you expect to sell in a given time period? Indicate your primary and secondary sources of data and the methods you used to estimate total market size and your market share. Part 5 of your textbook covers all marketing-related topics. These chapters should help you answer the questions in this part of the business plan.

The Marketing Plan Component

The marketing plan component is and should be unique to your business. Many assumptions or projections used in the analysis may turn out differently; therefore, this component should be flexible enough to be adjusted as needed.

The marketing plan should include answers to at least the following questions:

5.1. What are your target markets, and what common identifiable need(s) can you satisfy?

5.2. What are the competitive, legal, political, economic, technological, and sociocultural factors affecting your marketing efforts?

5.3. What are the current needs of each target market? Describe the target market in terms of demographic, geographic, psychographic, and product-usage characteristics. What changes in the target market are anticipated?

5.4. What advantages and disadvantages do you have in meeting the target market's needs?

5.5. How will your product distribution, promotion, and price satisfy customer needs?

5.6. How effectively will your products meet these needs?

5.7. What are the relevant aspects of consumer behavior and product use?

5.8. What are your company's projected sales volume, market share, and profitability?

5.9. What are your marketing objectives? Include the following in your marketing objectives:

- Product introduction, improvement, or innovation
- Sales or market share
- Profitability
- Pricing
- Distribution
- Advertising

Make sure that your marketing objectives are clearly written, measurable, and consistent with your overall marketing strategy.

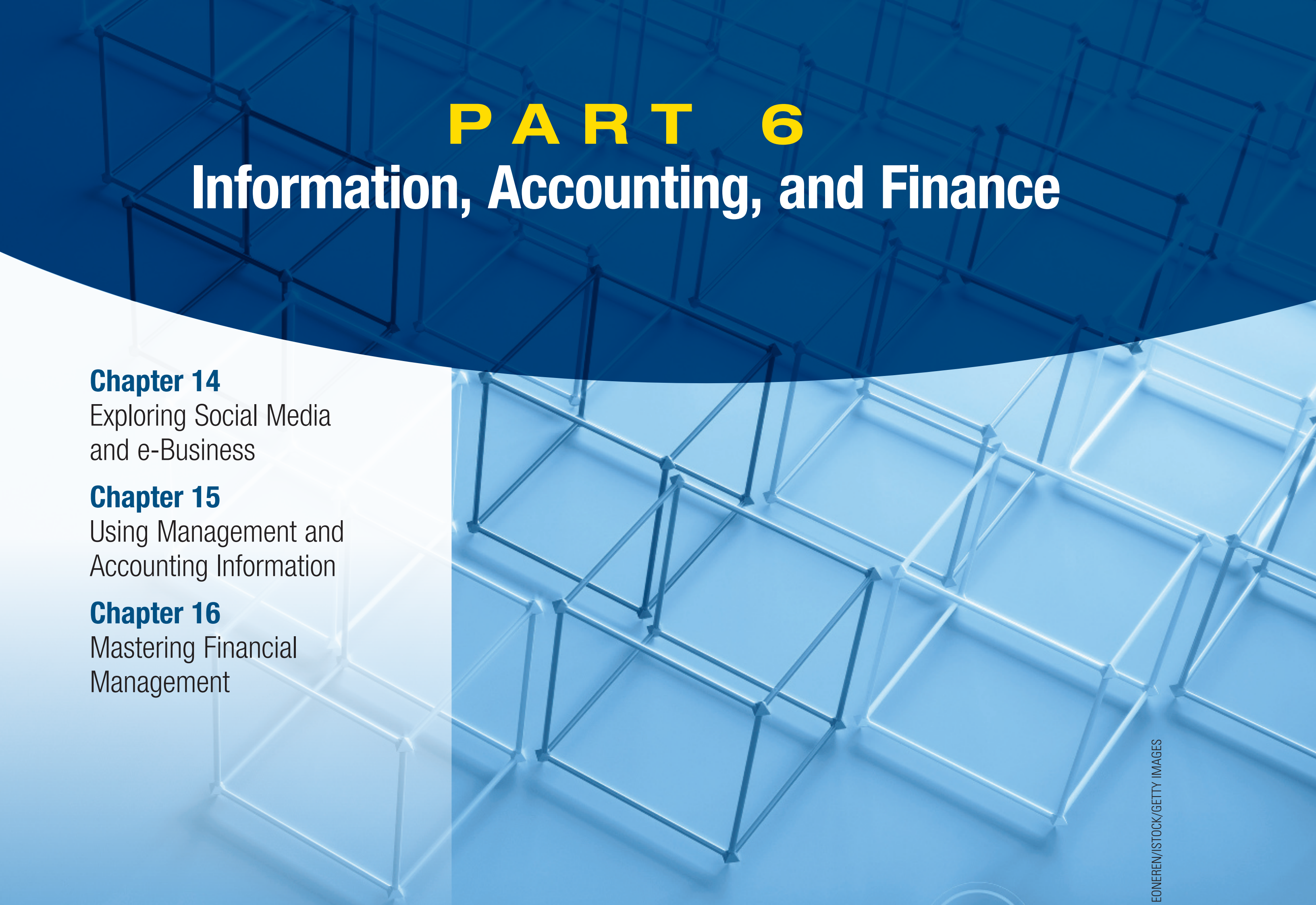
5.10. How will the results of your marketing plan be measured and evaluated?

Review of Business Plan Activities

Remember that even though it will be time-consuming, developing a clear, well-written marketing plan is important. Therefore, make sure that you have checked the plan for any weaknesses or problems before proceeding to Part 6. Also, make certain that all your answers to the questions in this and other parts are consistent throughout the business plan. Finally, write a brief statement that summarizes all the information for this part of the business plan.

PART 6

Information, Accounting, and Finance


EONEREN/ISTOCK/GETTY IMAGES

Chapter 14
Exploring Social Media and e-Business

Chapter 15
Using Management and Accounting Information

Chapter 16
Mastering Financial Management

IPOPBA/ISTOCK/GETTY IMAGES

In this part of Foundations of Business, we focus on how social media and e-business are changing the world of business. We also examine how management information, accounting, and financial management are used to ensure that money is available when needed, that it is obtained at the lowest possible cost, and that it is used as efficiently as possible.

Chapter

14

RAWPIXEL.COM/SHUTTERSTOCK.COM

Exploring Social Media and e-Business

Learning Objectives

Once you complete this chapter, you will be able to:

14-1 Examine why it is important for a business to use social media.

14-2 Discuss how businesses use social media tools.

14-3 Explain the business objectives for using social media.

14-4 Describe how businesses develop a social media plan.

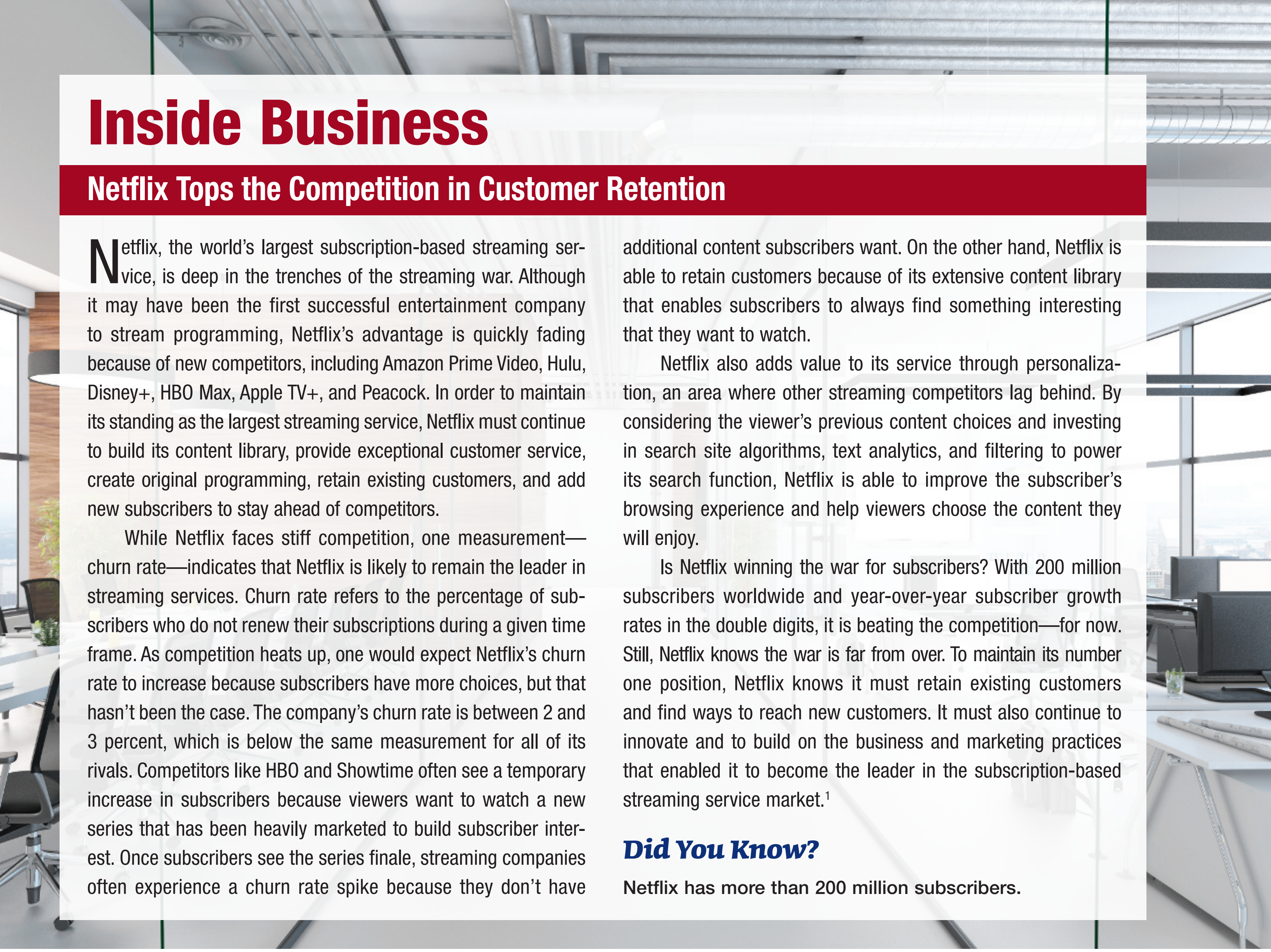
14-5 Explain the meaning of e-business.

14-6 Define the fundamental models of e-business.

14-7 Identify the factors that will affect the future of the internet, social media, and e-business.

Why Should You Care?

Question: How important are social media and e-business for a business today? Answer: Today, more and more businesses are using social media and e-business to reach new customers and increase sales and profits.



Inside Business

Netflix Tops the Competition in Customer Retention

Netflix, the world's largest subscription-based streaming service, is deep in the trenches of the streaming war. Although it may have been the first successful entertainment company to stream programming, Netflix's advantage is quickly fading because of new competitors, including Amazon Prime Video, Hulu, Disney+, HBO Max, Apple TV+, and Peacock. In order to maintain its standing as the largest streaming service, Netflix must continue to build its content library, provide exceptional customer service, create original programming, retain existing customers, and add new subscribers to stay ahead of competitors.

While Netflix faces stiff competition, one measurement—churn rate—indicates that Netflix is likely to remain the leader in streaming services. Churn rate refers to the percentage of subscribers who do not renew their subscriptions during a given time frame. As competition heats up, one would expect Netflix's churn rate to increase because subscribers have more choices, but that hasn't been the case. The company's churn rate is between 2 and 3 percent, which is below the same measurement for all of its rivals. Competitors like HBO and Showtime often see a temporary increase in subscribers because viewers want to watch a new series that has been heavily marketed to build subscriber interest. Once subscribers see the series finale, streaming companies often experience a churn rate spike because they don't have additional content subscribers want. On the other hand, Netflix is able to retain customers because of its extensive content library that enables subscribers to always find something interesting that they want to watch.

Netflix also adds value to its service through personalization, an area where other streaming competitors lag behind. By considering the viewer's previous content choices and investing in search site algorithms, text analytics, and filtering to power its search function, Netflix is able to improve the subscriber's browsing experience and help viewers choose the content they will enjoy.

Is Netflix winning the war for subscribers? With 200 million subscribers worldwide and year-over-year subscriber growth rates in the double digits, it is beating the competition—for now. Still, Netflix knows the war is far from over. To maintain its number one position, Netflix knows it must retain existing customers and find ways to reach new customers. It must also continue to innovate and to build on the business and marketing practices that enabled it to become the leader in the subscription-based streaming service market.[1]

Did You Know?

Netflix has more than 200 million subscribers.

Take a moment to think about how social media and e-business affect your own life. In just a few short years, it has changed the way we communicate with each other, it has changed the way we meet people, and it has changed the way we shop. It has also changed the way we watch television. Netflix, the company profiled in the Inside Business feature for this chapter, is the leader in subscription streaming services. And yet, Netflix has big-name competitors that want a share of this market. The fact there are so many companies competing for a share of a large global market is evidence of how important streaming services (and e-business) have become. In this chapter, we explore how these trends affect both individuals and businesses.

We begin this chapter by examining why social media is important for both individuals and business firms. Next, we discuss how companies can use social media to build relationships with customers, the objectives for social media, the steps to build a social media plan, and ways to measure the effectiveness of a firm's social media activities. In the last part of this chapter, we take a close look at how firms use e-business and technology to conduct business using computers and the internet and what growth opportunities and challenges affect both social media and e-businesses.

14-1 Why Is Social Media Important?

Learning Objective

14-1 Examine why it is important for a business to use social media.

Next time you go to lunch at your favorite restaurant or go to a ball game or the shopping mall, take a look at the number of people using their smartphones or even a tablet *and* social media to communicate with friends and relatives. In fact, if you are under the age of 40, you know exactly what social media is because you have grown up with computers and technology and are comfortable sharing information about yourself. If you are anyone else, social media seems like a strange (but exciting) phenomenon where millions of people freely share, create, vote, and connect with other people effortlessly using internet-based technologies.

14-1a What Is Social Media and How Popular Is It?

Today, there are many definitions of social media because it is still developing and continually changing. For our purposes, **social media** represents the online interactions that allow people and businesses to communicate and share ideas, personal information, and information about products and services. Simply put, social media is about people. It is about a culture of participation, meaning that people can now discuss, vote, create, connect, and advocate much easier than ever before. For example, you can post your plans for a weekend trip on Facebook. Then you can share a travel itinerary and chronicle your trip through videos, photos, and ratings on Facebook, Snapchat, Pinterest, Twitter, and other social media sites. While it's hard to imagine, many popular social media sites like Facebook and Google were only created in the past 25 years (refer to Figure 14-1). Because early social media sites were so successful, more sites were developed. For example, TikTok was launched in 2016 and had more than 675 million monthly users at the beginning of 2021.

social media the online interactions that allow people and businesses to communicate and share ideas, personal information, and information about products and services

So, how popular are social media sites? A recent Pew Internet Research study found that 70 percent of Facebook users visit the site each day as part of their daily routine. Other sites including Instagram (59 percent), Snapchat (59 percent), YouTube (54 percent), and Twitter (46 percent) also have a large percentage of users that visit each site every day.[2] Among the most popular worldwide social media sites are Facebook, which has approximately 2.7 billion users, YouTube, which has more than 2 billion users, and Instagram, which has more than 1 billion users.[3] These numbers increase daily as people log onto social media from home, from work, and from smartphones to stay in touch with family and friends, reconnect with old friends or classmates, share photos and videos, and obtain information available on the internet.

14-1b Why Businesses Use Social Media

Social media has completely changed the business environment. Just the sheer number of people using social media makes using social media a top priority for many business firms. Today, a business can use social media to:

- Connect with its customers and stakeholders;
- Provide information that is valuable to customers; and
- Provide another means of customer service.

Now many companies, large and small, are using social media to learn about customers' likes and dislikes, seek public input about products and marketing, and promote specific products. Macy's, for example, is active on Facebook, Twitter, Pinterest, YouTube, and a blog designed

FYV6561/SHUTTERSTOCK.COM

The leader! When it comes to social media, Facebook is the most popular site in the world and has more than 2.7 billion users. For many people, Facebook is the go-to site to keep up with friends and relatives or reconnect with people they haven't talked to in years. Other people just want to see what's happening in someone else's life.

Figure 14-1 Timeline for Many Popular Social Media Sites

Ever wonder when your favorite social media site was created? To answer that question, look at the timeline below.

	SOCIAL MEDIA BREAKTHROUGH
1998	• Google
2003	• LinkedIn
2004	• Facebook, Yelp
2005	• YouTube, Mashable
2006	• Twitter
2007	• Tumblr
2010	• Pinterest, Instagram
2011	• Snapchat, Twitch
2012	• Tinder
2013	• Vine, Telegram
2014	• Periscope
2016	• TikTok
The Future	• Who knows what the next generation of social media will mean for both individuals and business?

Note: Although there have been fewer internet and social media startups since 2016, they are usually small and when successful are often acquired by larger companies—many of the same companies listed in this figure.

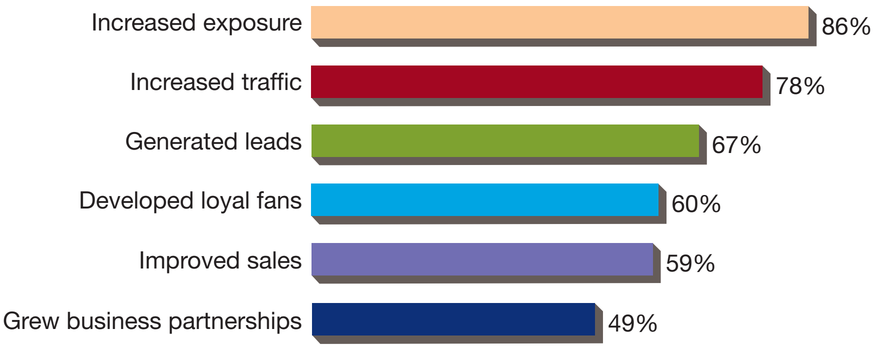
to be read on mobile screens. The company uses its Facebook site, for example, to provide fashion tips and news about new products and special events to communicate with its 14.6 million-plus Facebook fans. Often it uses the Twitter hashtag #Macys to highlight special in-store events and announce discounts and clearance sales. A **hashtag** is either a word or a short phrase, preceded by the pound sign (#), to identify different topics. On Pinterest, Macy's lets pictures do the talking with "pinned" images of the latest in beauty products, fashions, bridal registry items, and home decor. Its YouTube channel includes Macy's commercials, coverage of the annual Thanksgiving Day Parade, behind-the-scenes designer interviews, and videos about fashion trends.

The fact that so many people are actively sharing information about themselves and their likes and dislikes online for all to see was a driving force for many companies to develop a social media presence. Unlike social media, traditional marketing and advertising messages were top-down because companies used television, newspapers, and magazine ads to promote their product to a large audience without any opportunity for feedback. With social media, customers can and do provide feedback. If people have bad experiences with a product or service, they tend to let the world know by writing about it on a blog, mentioning it on Facebook, or tweeting about it. A recent survey by Customer Care Measurement and Consulting found that 66 percent of households experienced a problem with a product or service in the last 12 months, and many of the survey respondents used social media to complain. In addition, the survey also discovered that 55 percent of the respondents expect a response to a complaint posted on social media and nearly half of the same respondents got no response. Seventeen percent of customers who experience poor customer service tell their friends and neighbors to raise public awareness of their experience.[4] While companies no longer have much

hashtag a word or a short phrase, preceded by the pound sign (#), to identify different topics

Figure 14-2 The Six Most Important Benefits for a Business That Uses Social Media

While there are many reasons a business uses social media, the number one reason is that social media generates increased exposure for a business.



Source: Michael A. Stelzner, "2020 Social Media Marketing Industry Report," The Social Media Examiner, https://www.socialmediaexaminer.com/social-media-marketing-industry-report-2020/ (accessed May 11, 2020).

control over what is said about their products or services, many still respond to negative comments about the company and its products or services made by their customers. Even if the company's response doesn't completely resolve the issue, customers appreciate the company's effort to improve customer service.

In addition to complaints, companies often use social media to respond to questions and positive customer feedback to provide additional information and build customer goodwill. The bottom line: If businesses aren't using social media to see what customers are saying about their products or services, they are missing an opportunity to increase sales and profits. For more information about why businesses use social media (and the benefits for a business), refer to Figure 14-2.

✓ Concept Check

- According to material in this section, what are the reasons why people use social media?
- How has social media changed the environment for business firms?

14-2 Social Media Tools for Business Use

Learning Objective

14-2 Discuss how businesses use social media tools.

For a business, part of what makes social media so challenging is the sheer number of ways to interact with other businesses and existing and potential customers. For example, companies can use **social content sites** to create and share information about their products. Commercials, for example, can go viral on social media, especially when linked to major sporting events like the Super Bowl or the World Cup. Jeep, Doritos, and Facebook used social media to generate millions of online views for their Super Bowl commercials both before and after the game.[5] For businesses selling to other businesses, social content sites can also include webinars and online promotional materials. In addition to social content sites, businesses can use blogs, photos, videos, podcasts, and social media ratings to increase customer awareness of their products and services.

14-2a Business Use of Blogs

A **blog** is a website that allows a company to share information to increase customers' knowledge about its products and services, as well as to build trust. Once a story or information is posted, customers can provide feedback through comments, which is one of the most important ways of creating a conversation with customers, not just as existing or potential customers, but as people.

Blogs are effective at developing better relationships with customers, attracting new customers, telling stories about the company's products or services, and providing an active forum for testing new ideas. For example, the Brooklyn-based online crafts marketplace Etsy uses its blogs to communicate with both buyers and

social content sites websites which allow companies to create and share information about their products and services

blog a website that allows a company to share information to increase the customer's knowledge about its products and services, and to build trust

Exploring Careers

HBO Max Interns Rock TikTok

Social media is an ever-changing landscape, making it challenging for companies to keep up with emerging trends and platforms. To bring in a fresh perspective, HBO Max hired five interns, Ashley Xu, Gray Fagan, Preeti Singh, Conor Driscoll, and Paravi Das, to create TikTok videos to promote the HBO Max subscription video on demand service. While each video was tied to HBO Max and its entertainment content, they were also created to entertain and make viewers laugh and at the same time increase HBO Max's TikTok following. The move paid off. Because of the videos created by the interns, HBO Max's TikTok following increased from 29,000 to more than 728,000 followers at the time of publication of your text.

TikTok is a short-form mobile video platform known for viral memes, dancing, educational content, challenges, and comedic sketches. The key for businesses like HBO Max to succeed on TikTok is to create content that feels in line with the app's culture and target viewers. While there are exceptions, the majority of TikTok viewers are Gen Z (people born after 1997) and Millennials (people born between 1981 and 1996). To reach the target audience, the five interns began by creating a makeup challenge video to promote the HBO Max show *Euphoria*. The video went viral, receiving more than 3 million views. Their first video was topped by another of their videos that got more than 32 million views.

HBO Max's competitive paid internship program is immersive and hands-on. While someone doesn't need a degree in business or marketing to work in social media, a wide variety of skills are valuable in this arena. For example, Fagan was a film production major, Driscoll was a business administration major, and Singh was a public relations and advertising major. The interns pooled their knowledge of public relations, advertising, business, film production, and, of course, social media to produce 60-second TikTok skits to engage users on the platform. Their creativity and ability to tell stories made them an asset to the company. Though their internship was set to end, the students successfully pitched a proposal to HBO Max leadership to extend their stay. And, in typical fashion, the five made a TikTok video to go along with their proposal. End result: Their internship was extended for another three months.

Sources: Based on information in Sarah Whitten, "HBO Max Activations Double to 17.2 Million in Fourth Quarter," *CNBC*, January 27, 2021, www.cnbc.com/2021/01/27/hbo-max-activations-double-to-17point2-million-in-fourth-quarter.html; Kelsey Sutton, "HBO Max's Secret to Viral TikToks: Letting Their Interns Run the Account," *Adweek*, October 12, 2020, www.adweek.com/convergent-tv/hbo-max-secret-viral-tiktoks-interns; Michelle Anguka, "Savvy Storytelling, TikTok Skills Lead Chapman Film Students to HBO Max Internships," *Chapman University Newsroom*, October 7, 2020, https://news.chapman.edu/2020/10/07/savvy-storytelling-tiktok-skills-lead-chapman-film-students-to-hbo-max-internships/.

---

media sharing sites websites which allow users to upload photos, videos, and podcasts

sellers. Its blog posts, some written by artisans and some by Etsy personnel, profile online shops, highlight new fashion trends, teach do-it-yourself craft techniques, and showcase unusual and unique items for sale. Etsy also maintains a "Seller Handbook" blog to help sellers succeed on Etsy.

Digital Media

RAWPIXEL.COM/SHUTTERSTOCK.COM

14-2b **Photos, Videos, and Podcasts**

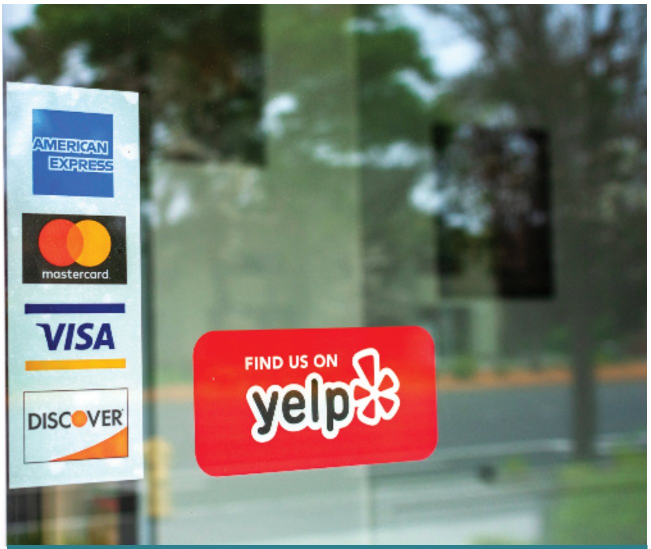
In addition to blogs, another tool for social content is **media sharing sites**, which allow users to upload photos, videos, and podcasts. Before creating a media sharing site, managers and employees should consider the following three factors:

- Who will create the photos, videos, and podcasts that will be used?
- How will the content be distributed to interested businesses and consumers?
- How much will it cost to create and distribute the material?

One increasingly popular form of media is photo sharing. Today, photo sharing provides a method for a company to tell a compelling story about its products or services through postings on either the company's website or a social media site. Target, Gap, and many other retailers, for example, post photos of clothing available in their stores or online on their Pinterest sites.

Videos have also gained popularity because of their ability to tell stories. Companies know that YouTube and other sites are useful because they are already recognized by other businesses and consumers as a source of both entertainment and information. For example, entertainment companies, like Disney and MGM, use YouTube to showcase movie trailers. Home Depot and Lowe's have also posted great do-it-yourself videos on their YouTube channels. For example, Martha Stewart has teamed up with Home Depot to create livestream videos that describe how you can create home décor. Other uses of livestream videos include online classes, interviews, and question and answer sessions with a social media influencer. An **influencer** is a person known on social media who has an influence over a large number of followers.

Podcasts are digital audio or video files that people listen to or watch online on tablets, computers, smartphones, or other mobile devices. Think of podcasts as programs that are distributed through various means and not linked to scheduled time periods. The great thing about podcasts is that they are available for download at any time. Shopify—an e-commerce site that provides e-commerce software and other management tools to help business start-ups and existing businesses—uses a series of podcasts to provide entrepreneurs with information that can be used to grow their businesses.



MICHAEL VI/SHUTTERSTOCK.COM

How do you find the best restaurant in town? Answer: Read the ratings social media users post on Yelp. While known for its restaurant reviews, the Yelp site also has ratings for shopping, automotive repairs, home services, and even nightlife. More than 175 million people visit the Yelp website each month to find out what other people think about local businesses.

14-2c Social Media Ratings

Social media enables shoppers to access ratings, reviews, opinions, recommendations, and referrals from others who have bought a product or service. Sites for reviews and ratings are based on the idea that consumers trust the opinions of others when it comes to purchasing products and services. According to a recent survey by BrightLocal, a marketing research company with locations in the United States and three other countries, 93 percent of consumers used the internet to find a local business in the last year.[6] Based on the early work of Amazon, eBay, Google, and Yelp, consumers can rate local businesses or compare products and services. In addition, individual businesses that range from retailers like Home Depot and Target to travel services like Priceline and Trip Advisor provide a way for consumers to share information about products and services.

According to consumers, the most important review factors are the overall star rating, if the review seems to be legitimate, if the reviews are current, and the number of reviews.[7] Consumer reviews are especially influential in certain purchase situations. For example, retailers, restaurants, medical services, repair services, and travel are types of businesses where ratings make a difference in consumer buying decisions. Knowing this, Wyndham Hotel Group puts the ratings of consumers who use TripAdvisor directly on its websites so travelers can see what others say about each individual hotel. By examining the reviews, Wyndham can get a good sense of its online reputation and identify specific areas for improvement.[8]

influencer a person known on social media who has an influence over a large number of followers

podcasts digital audio or video files that people listen to or watch online on tablets, computers, smartphones, or other mobile devices

✓ Concept Check

- What is a blog? How can a business use a blog to develop relationships with customers?
- What types of content can be used on a media sharing site? What factors should be considered when developing content for a media sharing site?
- How important are social media ratings for consumers? For businesses?

14-3 Achieving Business Objectives Through Social Media

Learning Objective

14-3 Explain the business objectives for using social media.

Although social media is a recent phenomenon, many businesses are already using it to achieve important objectives. Some of these goals are long term— such as building brand awareness and brand reputation—while others are more short term—such as increasing website traffic or generating sales leads. Regardless of how social media is used, there are a lot of business opportunities. In this section, we explore a few ways that companies have used social media effectively to achieve business objectives.

14-3a Social Media Communities

Social media communities are groups of people who share common interests and who want to use technology and the internet to connect with people with similar interests. People who are part of the communities can share information and even develop profiles. Individuals in a community can be called friends, fans, followers, or connections. Popular social networking sites include Facebook (the largest), LinkedIn (for professionals), Twitter, YouTube, Pinterest, and many others. To see how many businesses use the top six social media community sites, refer to Figure 14-3.

There are social communities for every interest, ethnic group, and lifestyle. Different types of social communities include forums and wikis. A **forum** is an interactive version of a community bulletin board that focuses on threaded discussions. These are particularly popular with people who share a common interest such as animal protection, health issues, or the latest movies. One of the most popular internet forums is Reddit, which is a massive collection of forums where people can share news and content and comment on other people's posts. Reddit is further broken down into subreddits, which are forums dedicated to specific topics. For example, there are subreddit communities for gaming, sports, television, travel, health and fitness, fashion, and many others. In reality, there are thousands of subreddits, and the number of subreddits continues to increase as more people with special interests interact on the Reddit site.

Another community based on social media is a wiki. A **wiki** is a collaborative online working space that enables members to contribute content that can be shared with other people. With wikis, members of the community are the editors and gatekeepers ensuring that the content is correct and updated. Wikipedia—the free online encyclopedia—is the best example of a wiki.

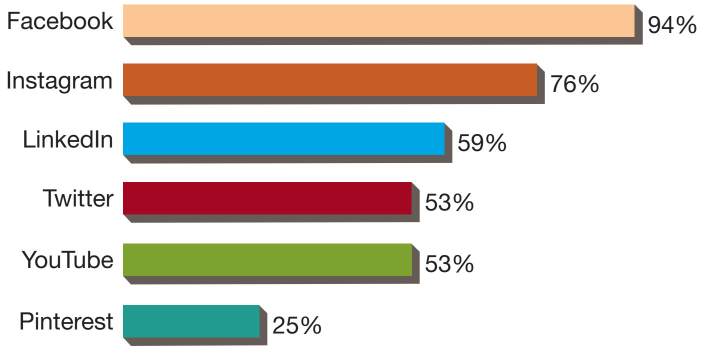
social media communities groups of people who share common interests and who want to use technology and the internet to connect with people with similar interests

forum an interactive version of a community bulletin board that focuses on threaded discussions

wiki a collaborative online working space that enables members to contribute content that can be shared with other people

Figure 14-3 The Top Six Social Media Networking Sites Used by Businesses

For businesses using social media, the most popular social networking sites are Facebook and Instagram.



Source: Michael A. Stelzner, "2020 Social Media Marketing Industry Report," The Social Media Examiner, socialmediaexaminer.com (accessed November 28, 2020).

Today, many companies and nonprofit organizations are using social media to build communities to achieve important objectives. For a business, developing social media communities is a way to interact with customers. Coca-Cola uses many different types of social media to build a community for people who want more information about Coca-Cola products and stories about Coke's involvement in the community. Because companies like Coca-Cola recognize the value of this type of social media, the largest companies now have a team of professionals to develop and monitor their social media activities led by a social media community manager. A **social media community manager** is a high-level executive who is responsible for all of a company's social media activities. Nonprofit organizations also use social media to promote and fund their programs. The nonprofit organization Kiva has helped build communities around the globe by matching lenders and struggling would-be entrepreneurs. Using Kiva to identify potential borrowers, anyone who can lend $25 (or more) can loan money to people who need a bit of cash to go into business or keep a business running. To date, there are 1.9 million Kiva lenders that have funded loans of more than $1.6 billion to people in 77 different countries.[9]

14-3b Crisis and Reputation Management

One of the most important reasons for listening to stakeholders is to determine whether there is a crisis brewing. Crises happen more often than most managers, employees, and customers realize. A recent survey by accounting firm PricewaterhouseCoopers (PWC) found that almost 70 percent of corporate managers have experienced a crisis in the last five years.[10] For example, consider the effect of the COVID-19 pandemic on businesses throughout the world. While the pandemic may have started in China, it quickly made its way to other regions including Europe, South America, and North America. Businesses in the United States were especially hit hard when non-essential businesses were in lockdown during spring 2020. Then the virus made a resurgence toward the end of the year. In many cases, social media was used to let customers know if businesses were open and what precautions they were using to keep both customers and employees safe during the pandemic. For example:

- Many businesses, including Home Depot, Lowe's, and Ace Hardware, were open, but strict requirements for masks, social distancing, and reduced operating hours were announced on their social media sites.
- Restaurants including Saltgrass Steakhouses, the Olive Garden, Red Lobster, and other national chains used social media to inform people of their operating hours and if they were open for food pick-up, delivery, or if dine-in was an option at some of their locations.
- Many manufacturers used social media to communicate with their customers—wholesalers, distributors, and retailers—about plant closures, product availability, and expected delivery dates.

Although the previous examples highlight how companies used social media to inform customers, employees, and stakeholders of the steps they were taking to fight a pandemic, often they will use social media to respond to negative reviews about the company's products or services. The following illustrates how Jet Blue Airlines handled a negative Twitter post.[11]

> **Customer** – *My view during all the flight (4 hours). No movies, no TV. First complaint to one of my favorite airlines. [Followed by an image of a blank TV screen]*
> **Jet Blue Response** – *Oh no! That's not what we like to hear! Were all the TVs out on the plane or is it just yours?*
> **Customer** – *Just my TV. The ones I saw next to me, everything was working.*
> **Jet Blue Response** – *We always hate it when that happens. Send us a direct message with your confirmation code to get you a credit for the non-working TV.*

social media community manager a high-level executive who is responsible for all of a company's social media activities

The Jet Blue Twitter team did a great job responding to this customer's complaint. First, they quickly acknowledged the problem, and then they asked for more information. Finally, they apologized and offered a credit for the non-working TV.

Although most companies spend more time responding to negative reviews, they also respond to positive complements about their product or service. In either case, the goal is to build customer goodwill, increase customer retention, and ultimately increase sales. Even though businesses can't anticipate when and what type of crisis will occur or when they will receive negative reviews, planning should begin before a problem situation develops. Employees should already be trained in social media etiquette and be monitoring social media sites to see what is said about the company and its products. During a crisis, companies can use social media to answer questions with carefully worded posts, reassure the public, and present positive information to help rebuild their reputations.

14-3c Listening to Stakeholders

Listening to people, whether they are customers or not, is always an important aspect of a company's social media plan. Indeed, listening is often the first step when developing a social media strategy. By monitoring Facebook, Twitter, or other social media sites, companies can determine what customers think about their products or services. If a company receives negative comments, it's important to respond

Technology and Innovation

VW's April Fools' Day Prank Backfires

While social media is a valuable tool to help brands recover in the wake of a reputational crisis, it can also be a threat to an organization's reputation. If a crisis is handled poorly, social media can amplify damage rather than restoring faith in the brand. Additionally, because of the viral nature of social media, news can quickly spread, putting a company in the global spotlight before a company even has time to respond to negative comments. Consider what happened with an April Fool's Day prank orchestrated by automaker Volkswagen.

April Fool's Day pranks often cause a stir on social media. VW discovered that's not always a good thing. The company leaked a phony press release saying it would change its name to Voltswagen to bring attention to its $86 billion push into the electric vehicle market. The company tweeted, "We know, 66 is an unusual age to change your name, but we've always been young at heart. Introducing Voltswagen. Similar to Volkswagen, but with a renewed focus on electric driving."

Unfortunately, many people, including reporters, did not realize it was a joke because it seemed authentic and was posted days ahead of April Fool's Day. The announcement was shared as a real news story on *USA Today*, *The Associated Press*, the *BBC*, *The Verge*, and dozens of other outlets. Social media users speculated about the press release for days before VW finally declared the announcement was a prank.

"What began as an April Fool's effort got the whole world buzzing," VW tweeted. "Turns out people are as passionate about our heritage as they are about our electric future. So, whether it's Voltswagen or Volkswagen, people talking about electric driving and our ID.4 can only be a good thing." (Note: ID.4 is VW's new electric SUV.) Consumers and the media did not agree, and the stunt was widely slammed.

The automaker, which was at the center of a previous emissions scandal where it lied to the public and regulators in 2015, has worked for years to repair its reputation. The April Fool's misstep dredged up memories of its unethical past. In fact, many media experts believe Volkswagen undermined its own efforts to move on from the emission scandal and eroded the company's trust and credibility.

Sources: Based on information in Aaron Gold, "How Volkswagen's 'Voltswagen' April Fools' Prank Backfired," *Motortrend*, April 5, 2021, www.motortrend.com/news/volkswagen-voltswagen-april-fools-day-prank-media-analysis; Sean O'Kane, "Volkswagen of America Lied about Rebranding to 'Voltswagen'," *The Verge*, March 30, 2021, www.theverge.com/2021/3/30/22357166/volkswagen-name-change-voltswagen-us-division; Volkswagen [@VW], *Twitter*, March 31, 2021, www.twitter.com/VW/status/1377263642702458881; @RationalEtienne, *Twitter*, March 31, 2021, www.twitter.com/RationalEtienne/status/1377369466158292995.

quickly. A personal response either on social media or a personal contact often will help resolve a complaint and at the same time restore customer goodwill. It also helps if the customer feels that the company will take action to correct the problem. For example, many companies encourage customers to complete quick surveys about products or services. Brinker International—parent company of Chili's and Maggiano's restaurants—provides customers with a link to a short survey on the bottom of their receipt. Customers are free to provide both positive and negative comments about their dining experience. Those comments are then used to fine-tune restaurant operations. In some cases, when negative reviews are justified, customers receive a personal note, a phone call, or an email reply that may be accompanied with a gift card to encourage customers to become return customers.

14-3d Targeting Customers

Many companies are using social media to increase awareness and build their brand among customers. It is especially valuable to target people based on their age. Common population age groups are often referred to as generations. For example, Generation Z (people born after 1997) is America's largest generation and accounts for 27 percent of the U.S. population.[12] Other generations in the U.S. population include:

- Millennials—people born between 1981 to 1996 and represent 25 percent;
- Generation X—people born between 1965 to 1980 and represent 20 percent;
- Baby Boomers—people born between 1946 to 1964 and represent 21 percent;
- The Silent Generation—people born between 1928 to 1945 and represent 7 percent; and
- The Greatest Generation—people born before 1928 and represent less than 1 percent.

To reach people who are included in each generation, it helps to identify who the customer is and what characteristics make the customer unique. For example, many people in Generation Z are now teenagers and represent younger consumers compared to people in the other generations. People in Generation Z grew up with technology, the internet, and social media. Facebook, Instagram, Snapchat, and YouTube are popular social media sites for people in this age group. In fact, Generation Z is quickly surpassing Millennials as a key target group of customers for retailers and manufacturers. For example, Nike—one of the most well-known brands in the world—recognizes Generation Z as one of the most important groups to reach on social media. In fact, Nike uses Instagram, Facebook, Twitter, YouTube, and Pinterest to reach out to people in each generation.[13] Each of these social media sites is used to promote Nike athletic footwear, clothing, and other items with many posts, photos, and social media activities directed to specific age groups in different generations. As a result of social media and other promotion activities, the Nike swoosh and its marketing phrase "Just Do It" are known throughout the world. And yet, the real story is that the brand isn't using social media to just sell a specific product; Nike is selling the benefits and image of its products that literally become part of a person's lifestyle.[14] For the company, the investment in social media has increased brand awareness, but more importantly increased sales and profits.

social media marketing the utilization of software, computer technology, and the internet to provide information about a firm's products and services, increase sales revenues, and improve customer service

SOCIAL MEDIA
MARKETING

ZAOZAA19/SHUTTERSTOCK.COM

14-3e Social Media Marketing for Consumers

Social media marketing is the utilization of software, computer technology, and the internet to provide information about a firm's products and services, increase sales revenues, and improve customer service.

As companies become more comfortable with social media, we can expect even more companies to use social media to market products and services to their customers. Already, research indicates that companies are shifting their advertising money from traditional marketing (like television and magazines) to digital marketing (like internet search engines and social media). Experts now predict that companies will shift more marketing dollars to digital marketing over the next few years. And by 2024, some experts expect that spending on digital marketing will account for more than 50 percent of the marketing budget for many firms.[15] The primary reason is simple: People are spending more time on social media sites. Often the first step for a business that wants to use social media is to go to Facebook, Twitter, Snapchat, YouTube, LinkedIn, or some other popular social media site. As you can see from the information in Figure 14-4, companies like Snapchat make using their technology as easy as possible to connect with potential or existing customers.

14-3f **Social Media Marketing for Other Businesses**

inbound marketing a marketing term that describes new ways of gaining attention, and ultimately customers, by creating content on a website that pulls customers in

Today, many companies have been quite successful using social media marketing not only to develop customer awareness, but also to obtain sales leads and increase actual sales to other businesses. HubSpot, for example, is a software company that helps companies develop inbound marketing programs. **Inbound marketing** is a marketing term that describes new ways of gaining attention, and ultimately customers, by

Figure 14-4 **Snapchat's Marketing Solutions for Businesses**

Like many social media sites, Snap's marketing tools help businesses connect with customers all over the globe. By using Snapchat, Domino's Pizza strengthened its brand awareness and surpassed both the company's and Snapchat's "success" benchmarks after a recent promotional campaign in Norway.

Domino's
LARGE FROM 129,-
TASTE OUR NEW AMERICAN SIZED PIZZA

SOURCE: DOMINO'S PIZZA

Source: Snapchat, https://forbusiness.snapchat.com/inspiration/dominos-strengthened-their-appeal-through-successful-campaign-on-snapchat, March 24, 2021.

creating content on a website that pulls customers in. Tools used for inbound marketing programs include search engine optimization, emails, blogging, videos, and social media. In order to market its software products, HubSpot shunned traditional advertising and began to practice what it preached. First, the company developed its own inbound marketing program by creating valuable content and marketing information that was then distributed through social media and search engine websites. Companies interested in HubSpot's software were required to enter contact information (name, phone number, and email address) in order to view the information because they believed the company's software could help them improve their marketing activities. As a result of HubSpot's inbound marketing program, the cost of generating new sales leads was reduced, the number of customers increased, and sales increased.

Companies also use social media marketing to sell goods and services, invite customer feedback, and reinforce a positive brand image. For General Electric (GE), social media marketing sets the stage for global sales of turbines, jet engines, and medical devices, among other products. GE is a social media innovator with award-winning videos, striking Instagram and Pinterest photos of its industrial products, followers on Facebook and Twitter, and a popular YouTube channel.

As important as social media marketing is, it is only one aspect of digital marketing. Indeed, digital marketing (sometimes referred to as online marketing) is comprised of several areas and also includes:

- *Search engine optimization*—using keywords in a company's website in order to rank higher in search engine results;
- *Search engine marketing*—buying advertising on sites like Google Ads to increase traffic to a company's website;
- *Display advertising*—buying banner ads; and
- *Email marketing*—targeting customers through opt-in email campaigns.

crowdsourcing outsourcing tasks to a group of people in order to tap into the ideas of the crowd

From an ethical perspective, all company employees should identify themselves during social media interactions with customers and be transparent about their role in digital marketing. For example, Intel, which makes computer chips, is one of many businesses that require disclosure of ties to the company when employees participate in different types of digital marketing.

14-3g Generating New Product Ideas

Companies can use social media to conduct much of their consumer-based research. Using insight gained from Facebook or Twitter, for example, allows a company to modify existing products and services and develop new ones. Another method, **crowdsourcing** involves outsourcing tasks to a group of people in order to tap into the ideas of the crowd. In some cases, valuable information can be obtained by crowd voting. Frito-Lay, for example, has used crowd voting to determine which television commercials to advertise its popular Doritos brand. The company has also used crowdsourcing for product development. And in 2020, Frito-Lay used crowdsourcing to honor ordinary people who do extraordinary things to create joy in their communities. Family and friends were able to nominate someone who goes to great lengths to inspire joy. Once the crowd—a national sample of 5,000 adults—chose the winners, Frito-Lay then redesigned its famous potato chip bags to feature the smiles of the winners.[16]

SUPAKORN LIMTEERAYOS/SHUTTERSTOCK.COM

The power of the crowd. LEGO—the Danish toymaker—uses crowdsourcing to generate new product ideas. Here's how it works. Customers can post and vote on ideas at https://ideas.lego.com. Ideas that get at least 10,000 votes are submitted to the company's review board. Then LEGO makes a final selection of promising ideas that begin the production process. For LEGO, the benefits include a new way to generate new product ideas and to build customer loyalty.

Companies can even build communities for specific brands in order to obtain information and new ideas from consumers. The Danish toymaker LEGO has created an online site called LEGO Ideas (https://ideas.lego.com) where brand enthusiasts can post and vote on new product ideas. LEGO benefits from its customers' creativity and the goodwill generated by seeking the community's input. Just as important, the creators receive credit for their ideas plus a small royalty from product sales.[17]

14-3h **Recruiting Employees**

For years, companies have used current employees to recruit new employees based on the theory that "birds of a feather flock together." The concept is simple: Current employees' friends and family may prove to be good job candidates. Social media takes that concept to a whole new level. LinkedIn, the largest social network for professionals, has been used quite effectively by large corporations, small businesses, nonprofit organizations, and government agencies that want to recruit new employees. Because LinkedIn hosts more than 750 million registered members, employers using the site can save time, reduce their recruiting costs, and see more information about individual candidates.[18] Companies like 3M, Coca-Cola, Four Seasons Hotels and Resorts, Hewlett Packard, IBM, Microsoft, Procter & Gamble, and many others have all had recruiting success with LinkedIn. Many other social media sites, including Glassdoor, Facebook, Instagram, and YouTube, can also be used for networking and to learn about a company where you might want to work.

✓ Concept Check

- In your own words, describe how social media can help businesses to connect with other businesses and consumers.
- For a business, why are crisis and reputation management, listening to stakeholders, and targeting specific types of customers important activities?
- How can social media be used to market a firm's products or services to consumers and other businesses?
- How can social media help a firm generate new product ideas and recruit employees?

14-4 Developing a Social Media Plan

Learning Objective

14-4 Describe how businesses develop a social media plan.

Before developing a plan to use social media, it is important to determine how social media can improve the organization's overall performance and how it "fits" with a company's objectives and other promotional activities. For example, if a social media plan attempts to improve customer service, it needs to link to the company's other efforts to improve customer service.

14-4a **Steps to Build a Social Media Plan**

Once it is determined how social media links to the company's other activities, there are several steps that should be considered.

Step 1: Listen to Determine Opportunities As pointed out earlier in this chapter, social media is often used to "listen" to what customers like and don't like about a company's products or services. For example, reading comments on social media sites can yield some insight into how consumers are reacting to a price increase for an existing product or service. Monitoring social media sites also allows managers and employees to not only listen but also to enter the conversation and tell the company's side of the story. In addition, companies can monitor social media sites to gather information about competitors as well as what is being said about the industry.

Step 2: Establish Social Media Objectives After listening to customers and analyzing the information obtained from social media sites, it is important to use that information to develop specific objectives. For social media, an objective is a statement about what a social media plan should accomplish. Each objective should be specific, measurable, achievable, realistic, and oriented toward the future. In addition, all objectives need to be linked to specific actions that can be used to accomplish each objective.

For most companies, the most popular objectives are:[19]

- Improving customer service
- Increasing brand awareness

- Building brand presence
- Acquiring new customers
- Developing loyalty programs

Other objectives that are often important for many firms include introducing new products, improving search engine ranking, and increasing the number of people who visit the company's social media sites.

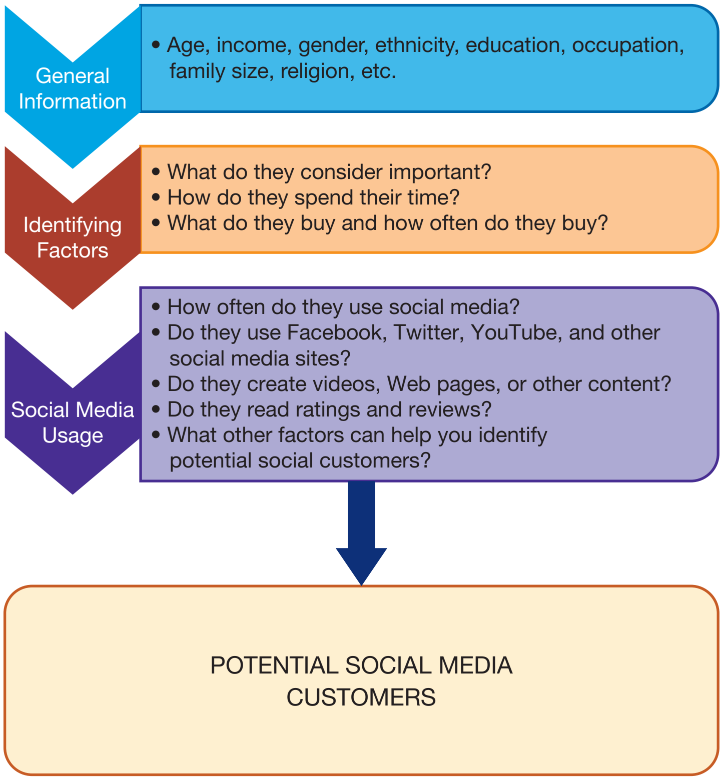
Step 3: Segment and Target the Social Media Customer Ideally, a company will have developed a customer profile that describes a typical customer in terms of age, income, gender, ethnicity, etc. When segmenting or targeting customers, it also helps to know how they think, how they spend their time, how much they buy, and how often they buy. Additionally, it is important to really understand how customers use social media.

- Do they create content like photos, videos, blog posts, etc.?
- Do they use social media for information, ratings, and reviews?
- Do they spend a lot of time using social media?

More information about potential customers will help you develop a social media plan to achieve a company's objectives. Lack of information about customers can lead to wasted time and money and the inability to successfully achieve the firm's social media objectives. For example, most companies feel that they must use Facebook, Instagram, and Twitter. But if their core customer does not use these social media sites, then it does not make sense to use them. Some of the information that can help you target just the "right" social media customer is illustrated in Figure 14-5.

Figure 14-5 **Types of Information That Can Help Target Different Social Media Customers**

The more information you have about customers, the easier it is to develop a social media plan that targets the "right" customer.


General Information
• Age, income, gender, ethnicity, education, occupation, family size, religion, etc.
Identifying Factors
• What do they consider important?
• How do they spend their time?
• What do they buy and how often do they buy?
Social Media Usage
• How often do they use social media?
• Do they use Facebook, Twitter, YouTube, and other social media sites?
• Do they create videos, Web pages, or other content?
• Do they read ratings and reviews?
• What other factors can help you identify potential social customers?
POTENTIAL SOCIAL MEDIA CUSTOMERS

Step 4: Select Social Media Tools The search for the right social media tool(s) usually begins with the company's social media objectives, outlined in Step 2. It also helps to review the target customer or segment of the market the company is trying to reach (Step 3). With this information, the next step is to choose the right social media tools to reach the right customers. A company can use social media content sites, blogs, photos, videos, podcasts, or crowdsourcing to reach potential or existing customers. For example, if the goal is to recruit college graduates for sales positions for a large pharmaceutical company, LinkedIn may be a good choice. Remember, it is not necessary (or even advisable) to use all of the above tools. It is also possible for a business to build a social media community—especially when the objective is to fund business start-ups. Often money for worthwhile projects is obtained through crowdfunding. **Crowdfunding** is a method of raising money to fund a project for a business, a nonprofit organization, or an individual. The money raised can be an investment, a loan, or a donation. For example, a young startup company, Oculus VR, used Kickstarter—a crowdfunding site to raise $250,000. The money (along with later funding from venture capitalists) was used to build a virtual-reality headset, Oculus Rift, that puts players into their favorite games. Oculus VR was so successful that later Facebook bought the company for $2 billion.[20]

Step 5: Implement and Integrate the Plan Once social media tools have been identified, a company can implement and integrate the social media plan. Because a social media plan doesn't necessarily have a start and stop date, it is different from traditional advertising campaigns. Some social media activities continue and have a life of their own. For example, Zappos, a very successful online retailer, is a company that is always "on" in terms of its social media. Indeed, they do very little traditional advertising and instead rely on the company's website and social media to promote products, monitor customer service, and enhance the company's reputation. If a customer uses social media to complain, their customer service representatives will often contact the customer and try to resolve any problems the customer has experienced. This customer-focused approach often leads to increased customer satisfaction and increased sales.

Some companies, on the other hand, feel that it is important to have a mix of short- and long-term social media promotion. In this case, it's important to key the content to each social media site and to coordinate the timing of promotions. For example, Coca-Cola is constantly adding new features to its Facebook page, which has more than 105 million likes. One day, the company might post its latest video. The next day, it might invite visitors to participate in a survey. Knowing that customers post thousands of social media messages about its brand every day, Coca-Cola also monitors social media sites very carefully and responds quickly to questions and comments. Finally, like a growing number of companies, Coca-Cola integrates its social media and traditional marketing efforts for maximum impact and to get "more bang for the buck."

14-4b Measuring and Adapting a Social Media Plan

Because social media is a relatively new method of reaching customers, many companies struggle when attempting to measure social media. Generally, there are two types of social media measurement. While both quantitative and qualitative measurements can be used, most companies tend to use quantitative measurements.

crowdfunding a method of raising money to fund a project for a business, a nonprofit organization, or an individual

quantitative social media measurement using numerical measurements, such as counting the number of website visitors, number of fans and followers, number of leads generated, and the number of new customers

Quantitative Social Media Measurement **Quantitative social media measurement** consists of using numerical measurements, such as counting the number of website visitors, number of fans and followers, number of leads generated, and the number of new customers. Table 14-1 shows a few popular quantitative ways to measure social media. A company like Macy's counts not

Table 14-1 **Quantitative Measurements for Selected Social Media Websites**

Type of Social Media	Typical Measurements
Blogs	• Unique visitors • Number of views • Ratio of visitors to posted comments
Twitter	• Number of followers • Number of tweets and retweets • Click through rate (CTR) of tweeted links • Visits to website from tweeted links
Facebook	• Number of likes • Number of comments and responses • Visits to websites from Facebook links
YouTube	• Number of videos • Number of visitors • Ratio of comments to the number of videos • Watch time

only the number of social media likes and followers but also the number of times the company is mentioned each day. Although such measures help the company gauge brand awareness, determining how social media affects actual purchases of consumer products, like clothing and jewelry, can be difficult. Business-to-business marketers frequently set additional goals to track how social media activities lead to sales contacts and then to purchases. SAP North America, which markets software and technology services to corporations, uses social media to generate leads and facilitate the sales process. For example, SAP sponsors special events, workshops, and presentations that showcase the firm's software products. Both current and prospective customers often find out about these programs by accessing the firm's social media sites. To attend many of these events, people must register and provide basic contact information. Later, the person's contact information is used to initiate future sales calls.[21] By tracking such contacts, SAP can determine the effect of its programs on the company's sales revenues.

A number of companies are also using key performance indicators to measure their social media activities. **Key performance indicators (KPIs)** are measurements that define and measure the progress of an organization toward achieving its objectives. Generally, KPIs are *quantitative* (based on numbers like the number of YouTube views).

If measuring the success or failure of social media activities with KPIs, the first step is to connect KPIs with objectives. The second step is to set a benchmark—a number that shows what success should look like. Assume Mercedes-Benz sets a benchmark of 750,000 views for a new YouTube video that introduces a new S-Class model automobile. If at the end of a specified time period, 840,000 people have viewed the video, it would indicate the company's video campaign was successful.

Qualitative Social Media Measurement **Qualitative social media measurement** is the process of accessing the opinions and beliefs about a brand. This process primarily uses sentiment analysis to categorize what is being said about a company. **Sentiment analysis** is a measurement that uses technology to detect the mood,

key performance indicators (KPIs) measurements that define and measure the progress of an organization toward achieving its objectives

qualitative social media measurement the process of accessing the opinions and beliefs about a brand

sentiment analysis a measurement that uses technology to detect the mood, attitudes, or emotions of people who experience a social media activity

BLACK SALMON/SHUTTERSTOCK.COM

Quantitative or qualitative measurements—Which one is best? That's a hard question to answer. Both methods can be used to measure the effectiveness of a company's social media plan. Quantitative measurements are numerical, like the number of visitors to a site. Qualitative measurements analyze a customer's sentiments, like what people think about a company's customer service. Sometimes just asking customers to check a box if they like a product or service or not is all it takes.

attitudes, or emotions of people who experience a social media activity. Other measurements for determining customer sentiment include:

- *Customer satisfaction score*—the relative satisfaction of customers;
- *Issue resolution rate*—the percentage of customer service inquiries resolved satisfactorily using social media; and
- *Resolution time*—the amount of time taken to resolve customer service issues.

When compared to quantitative measurement, it should be noted that many of these qualitative social media measurements are more subjective in nature.

14-4c The Cost of Maintaining a Social Media Plan

Basic assumption: Social media is not free and can be quite expensive. Because social media costs both time and money, it is important to measure the success of a social media plan and make adjustments and changes if needed. Based on quantitative and qualitative measurements, the company may also try to determine if it is getting a positive return on its investment in social media.

After reviewing results for social media activities against pre-established benchmarks, it may be necessary to make changes and update the plan to increase the effectiveness of the social media plan. A social media plan, for example, must provide current and up-to-date information in order to keep customers coming back to see what's new. Without updates, customers lose interest and the number of returning customers can drop dramatically. After all, one of the major objectives of social media activities is to provide customers and stakeholders with current and useful information about the company and its products or services. Once it is determined that updates and changes are needed, many of the same steps described in this section may be used to improve a firm's social media plan. It is also important to create future social media plans based on what worked and what didn't work in previous plans.

Social media is particularly important to businesses that use computers and the internet to sell their products and services online. In the next section, we take a close look at how e-business firms are organized, satisfy needs online, and earn profits.

✓ Concept Check

- What are the steps required to develop a social media plan?
- What is the difference between quantitative and qualitative measurements? Which type of measurement do you think is the most reliable when measuring the effectiveness of a company's social media plan?

14-5 Defining e-Business

Learning Objective

14-5 Explain the meaning of e-business.

In Chapter 1, we defined *business* as the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs. Working from this original definition, then, **e-business (**or **electronic business)**, can be defined as the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs *through the facilities available on the internet*. Sometimes people use the term *e-commerce* instead of *e-business*. In a strict sense, e-business is used when you're talking about all business activities and practices conducted on the internet by an individual firm or industry. On the other hand, **e-commerce** is a part of e-business and usually refers only to buying and selling activities conducted online. Although actual statistics vary depending on the source, U.S. e-commerce retail sales already account for approximately $432 billion a year and are expected to increase to $563 billion by 2025.[22]

With the popularity of smartphones and tablet computers, many companies are also using **mobile marketing** to communicate with and sell to customers through mobile devices. Mobile marketing covers a range of activities, from optimizing websites for viewing on smartphones and tablets to delivering promotional messages and discounts via mobile devices. Because mobile devices are used in over 40 percent of online transactions, many businesses are investing more heavily in mobile marketing.[23] A growing number of companies have *apps* to make mobile

e-business (or **electronic business)** the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs through the facilities available on the internet

e-commerce a part of e-business and usually refers only to buying and selling activities conducted online

mobile marketing communicating with and selling to customers through mobile devices transactions faster and more convenient for customers. For example, Starbucks offers an easy-to-use app for customers to pay for their lattes or espressos directly from a smartphone or tablet.

14-5a **Organizing e-Business Resources**

As noted in Chapter 1, to be organized, a business must combine *human, material, informational,* and *financial resources*. This is true of e-business, too (refer to Figure 14-6), but in this case, the resources may be more specialized than in a typical business. For example, people who can design, create, and maintain websites are only a fraction of the specialized human resources required by e-businesses. Material resources often include customized computers and high-speed internet connections. Computer software programs that track the number of visitors who view a firm's website and customers who make online purchases are generally among the specialized informational resources required. Financial resources, the money required to start and maintain the firm and allow it to grow, usually reflect greater participation by individual entrepreneurs, venture capitalists, and investors willing to invest in a high-tech firm instead of conventional financial sources such as banks.

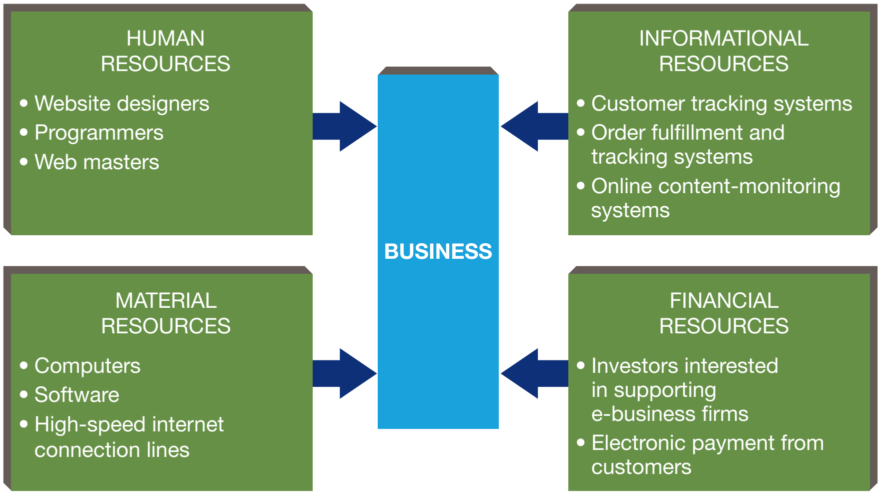
In an effort to reduce the cost of specialized resources that are used in e-business, many firms have turned to outsourcing. **Outsourcing** is the process of finding outside vendors and suppliers that provide professional help, parts, or materials at a lower cost. For example, a firm that needs computer programmers and specialized software to complete a project may turn to an outside firm located in another part of the United States, India, or an Eastern European country.

14-5b **Satisfying Needs Online**

The internet has created some new customer needs that did not exist before its creation. Consider what happened during the second quarter (April, May, and June) of 2020. e-Commerce sales grew an average of 45 percent when compared to the same period the previous year.[24] The growth was the result of the COVID-19 pandemic. Because of a shutdown of non-essential businesses and fear for the health of not only themselves but also their families, customers turned to online shopping to obtain the products they needed. For the remainder of the year, the growth rate for e-commerce continued to rise to record levels. For example, 44 percent more

Figure 14-6 **Combining e-Business Resources**

While all businesses use four resources (human, material, informational, and financial), these resources are typically more specialized when used in an e-business.


HUMAN RESOURCES
• Website designers
• Programmers
• Web masters
INFORMATIONAL RESOURCES
• Customer tracking systems
• Order fulfillment and tracking systems
• Online content-monitoring systems
BUSINESS
MATERIAL RESOURCES
• Computers
• Software
• High-speed internet connection lines
FINANCIAL RESOURCES
• Investors interested in supporting e-business firms
• Electronic payment from customers

outsourcing the process of finding outside vendors and suppliers that provide professional help, parts, or materials at a lower cost

Entrepreneurial Success

Why Small Businesses Like Shopify

In 2004, Tobias Lütke, Daniel Weinand, and Scott Lake came up with the idea for Shopify, a Canadian e-commerce platform, while opening a small online business for snowboarding equipment called Snowdevil. The three entrepreneurs were dissatisfied with existing e-commerce sites, so Lütke, a computer programmer, decided to build his own. Two years later, the platform hosting Snowdevil was launched as Shopify.

Now, more than 1 million businesses in 175 countries use Shopify to sell merchandise. One of the keys to Shopify's success is that instead of positioning itself as a traditional e-commerce platform, it markets itself as a one-stop-shop for business owners to start, run, and grow their businesses. Small business owners that use Shopify typically use a variety of services, including email marketing, website hosting, logistics management, and point-of-sale software. This all-in-one approach is attractive for small business owners who have limited time, resources, and technical expertise because it eliminates the need to deal with third parties to get the tools that they need to operate their businesses. For example, its customizable themes and drag-and-drop store builder tool eliminate the need for design skills. Another attractive feature allows Shopify users to sync online and in-store sales using its point-of-sales software. According to many users, Shopify offers solutions, tools, and services that were previously unavailable for many small business owners for a relatively small monthly fee.

Shopify was already growing steadily when the COVID-19 pandemic struck. With lockdown restrictions in place for many nonessential businesses and an increasing number of customers shopping online, many small business owners scrambled to get their businesses online. Shopify enticed new users by extending its 14-day free trial to 90 days for a limited time on select plans. Extending the free trial gave customers more time to determine if Shopify was the right e-commerce platform for them. As a result, Shopify experienced rapid growth.

Small business owners aren't the only ones enjoying everything Shopify has to offer. Major brands such as Pepsi, Heinz, and Staples also use the Shopify e-commerce platform. While it faces a variety of e-commerce competitors, including Adobe's Commerce, BigCommerce, WooCommerce, Wix, and even Amazon, Shopify stands out from the competition because of its ability to meet the needs of its small-business customers.

Sources: Based on information in Lauren Debter, "During Pandemic, Shopify Woos A Wave Of Small Businesses Eager To Get Online," *Forbes*, May 8, 2020, www.forbes.com/sites/laurendebter/2020/05/07/shopify-small-businesses-online-coronavirus; Matt Grossman and Kimberly Chin, "Shopify's Revenue Nearly Doubles as Covid-19 Pushes Shopping Online," *The Wall Street Journal*, July 30, 2020, www.wsj.com/articles/shopifys-revenue-nearly-doubles-as-covid-19-pushes-shopping-online-11596057094; Laura Forman, "Shopify's Business Sells Itself, for Now," *The Wall Street Journal*, July 29, 2020, www.wsj.com/articles/shopifys-business-sells-itself-for-now-11596041071.

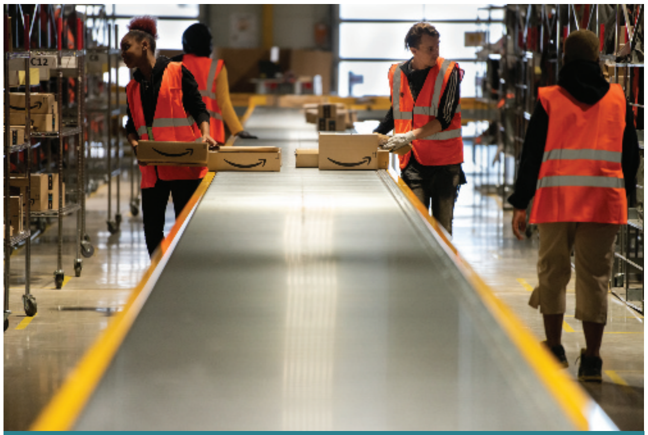
people made purchases online during the Thanksgiving to Cyber Monday period in 2020 when compared to the previous year.[25] This increase was caused by people avoiding crowded stores that are typical of this holiday season. Now even as people return to more normal times, many experts predict online sales will continue to increase and sales in brick-and-mortar stores will decline in the future. While there are many reasons for the increase in e-commerce and online shopping, major reasons include the ability to:

- Save time when compared to shopping at the mall or store;
- Compare prices for the same product on different websites;
- Read customer reviews;
- Avoid checkout lines; and
- Have products delivered without leaving home.

In addition to purchasing products, the internet can be used by both individuals and business firms to obtain information. For example:

- Internet users can access newspapers, magazines, radio, and television programming at a time and place convenient to them.

- The internet provides the opportunity for two-way interaction between an internet firm and the customer. For example, many new-car dealers have a "chat" option on their websites for customers who can ask specific questions or want more information about their automobiles or service.
- Finally, the internet allows customers to choose the content they are offered. For the advertiser, knowing that its advertisements are being directed to the most likely customers represents a better way to spend advertising dollars.



FREDERIC LEGRAND – COMEO/SHUTTERSTOCK.COM

Who is the largest retailer in the world? Walmart is number one when you measure total sales from brick-and-mortar stores *and* e-commerce. And yet, if you *measure just e-commerce sales*, Amazon is larger. One of the reasons why Amazon is the leader in online retailing is that it is easy to purchase just about anything you want and have it delivered in a few days or even the same day in some locations. Now that's fast.

14-5c Creating e-Business Profit

Business firms can increase profits either by increasing sales revenue or by reducing expenses through a variety of e-business activities.

Increasing Sales Revenue Each source of sales revenue flowing into a firm is referred to as a **revenue stream**. Today, there are many different ways to use the internet and technology to increase sales revenue. Because the opportunity to shop on the internet is virtually unrestricted, traditional retailers like Target (www.target.com) and Walmart (www.walmart.com) can obtain additional revenue by selling to a global customer base 24 hours a day, seven days a week. However, shifting revenues earned from customers inside a real store to revenues earned from these same customers online does not create any real new revenue for a firm. The goal is to find *new customers* that shop online and generate *new sales* so that *total revenues are increased*.

Intelligent information systems also can help to generate sales revenue for internet firms such as Amazon (www.amazon.com). Such systems store information about each customer's purchases, along with a variety of other information about the buyer's preferences. Using this information, the system can assist customers the next time they visit the website. For example, if the customer has bought a Carrie Underwood CD in the past, the system might suggest CDs by similar artists who have won awards from the Academy of Country Music.

Many internet firms generate revenue from commissions earned from sellers of products linked to their internet sites. For example, both Amazon and eBay earn revenue by providing a website where vendors can sell merchandise to buyers who may be located any place in the world.

Although some customers may not make a purchase online, the existence of the firm's website and the services and information it provides may lead to increased sales in the firm's physical stores. For example, Honda's website (www.honda.com) can provide basic comparative information for shoppers so that they are better prepared for their visit to an automobile showroom.

In addition to selling products or services online, e-business revenue streams are created by advertising placed on web pages and by subscription fees charged for access to online services and information. For example, Dun & Bradstreet (www.dnb.com/), a comprehensive source for company and industry information, makes some of its online content free for anyone who visits the site, but more detailed information is available only by paid subscription.

Reducing Expenses Reducing expenses is the second major way in which e-businesses can help to increase profitability. Providing online access to information

revenue stream a source of revenue flowing into a firm that customers want can reduce the cost of dealing with customers. T-Mobile (www.t-mobile.com), for instance, is just one company that maintains an extensive website where potential customers can learn more about products and services, and where current customers can access personal account information, send questions to customer service, and purchase additional products or services. With such extensive online services, T-Mobile does not have to maintain as many physical store locations as it would without these online services. We examine more examples of how e-business contributes to profitability throughout this chapter, especially as we focus on some of the business models for activity on the internet.

✓ Concept Check

- What are the four major factors contained in the definition of e-business?
- How does e-business satisfy needs online?
- How do e-businesses generate revenue streams, reduce expenses, and earn a profit?

14-6 Fundamental Models of e-Business

Learning Objective

14-6 Define the fundamental models of e-business.

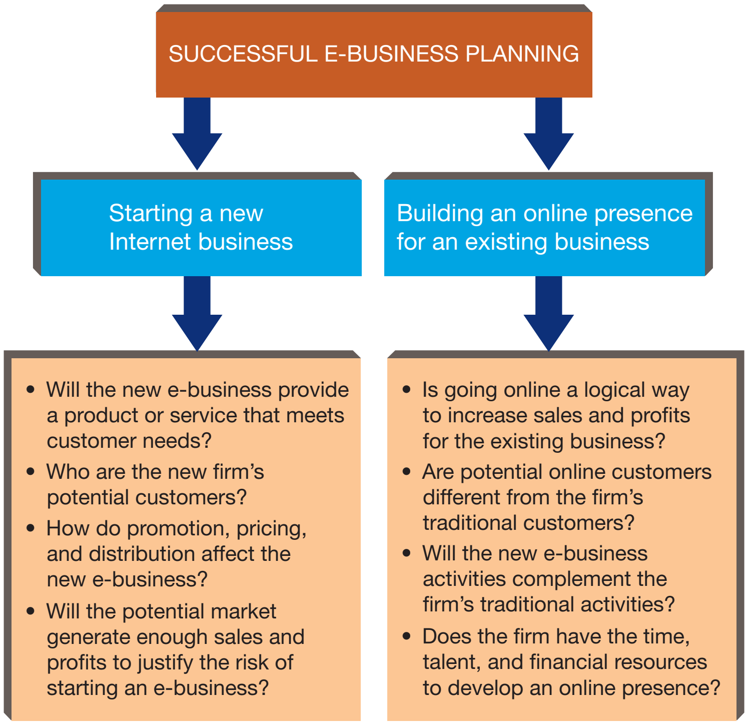
A **business model** represents a group of common characteristics and methods of doing business to generate sales revenues and reduce expenses. Each of the models discussed in the following text represents a primary e-business model. Regardless of the type of business model, planning often depends on if the e-business is a new firm or an existing firm adding an online presence—refer to Figure 14-7. It also helps to keep in mind that in order to generate sales revenues and profits, a business—especially an e-business—must meet the needs of its customers.

14-6a Business-to-Business (B2B) Model

Some firms use the internet mainly to conduct business with other businesses. These firms are generally referred to as having a **business-to-business** (or **B2B) model.**

Figure 14-7 **Planning for a New Internet Business or Building an Online Presence for an Existing Business**

The approach taken to creating an e-business plan will depend on whether you are establishing a new Internet business or adding an online component to an existing business.

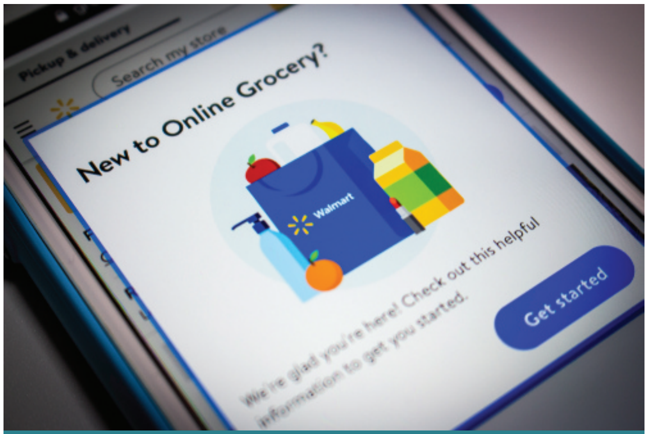

SUCCESSFUL E-BUSINESS PLANNING
Starting a new Internet business
Building an online presence for an existing business
• Will the new e-business provide a product or service that meets customer needs?
• Who are the new firm's potential customers?
• How do promotion, pricing, and distribution affect the new e-business?
• Will the potential market generate enough sales and profits to justify the risk of starting an e-business?
• Is going online a logical way to increase sales and profits for the existing business?
• Are potential online customers different from the firm's traditional customers?
• Will the new e-business activities complement the firm's traditional activities?
• Does the firm have the time, talent, and financial resources to develop an online presence?

business model a model that represents a group of common characteristics and methods of doing business to generate sales revenues and reduce expenses

business-to-business (or **B2B) model** a model used by firms that conduct business with other businesses

When examining B2B firms, two clear types emerge. In the first type, the focus is facilitating sales transactions between businesses. For example, Dell manufactures computers to specifications that customers enter on the Dell website (www.dell.com). A large portion of Dell's online orders are from corporate clients who are well informed about the products they need and are looking for fairly priced, high-quality computer products that will be delivered quickly. By dealing directly with Dell, customers eliminate costs associated with wholesalers and retailers, thereby helping to reduce the price they pay for equipment.

A second, more complex type of B2B model involves a company and its suppliers. Today, suppliers use the internet to bid on products and services they wish to sell to a business customer and learn about the customer's rules and procedures that must be followed. For example, Ford, General Motors, and Chrysler have developed a B2B model to link thousands of suppliers that sell the automobile makers parts, supplies, and raw materials worth millions of dollars each year. Although the B2B site is expensive to start and maintain, there are significant savings for all three automakers. Given the potential savings, it is no wonder that many other manufacturers and their suppliers are beginning to use the same kind of B2B systems that are used by the automakers.


Pickup & delivery
Search my store
New to Online Grocery?
Walmart
We're glad you're here! Check out this helpful information to get you started.
Get started

KOSHIRO K/SHUTTERSTOCK.COM

Tired of standing in the checkout line at the grocery store? Then shop online. Many supermarket chains are experiencing an uptick in the number of consumers who are using their e-commerce sites to buy groceries. For consumers, the process is simple: Order your merchandise online, pay online, and then either pick up your groceries at the store's customer pickup location or have your purchases delivered to your home.

14-6b Business-to-Consumer (B2C) Model

In contrast with the B2B model, firms such as Amazon (www.amazon.com), Walmart (www.walmart.com), and Dick's Sporting Goods (www.dickssportinggoods.com) clearly are focused on individual consumers. These companies are referred to as having a **business-to-consumer (**or **B2C) model**. In a B2C situation, understanding how consumers behave online is critical to a firm's success. Typically, a business firm that uses a B2C model must answer the following questions:

- What sorts of products and services are best suited for online consumer shopping?
- Will consumers use websites to simplify and speed up comparison shopping?
- Will consumers purchase services and products online or end up buying at a traditional retail store?
- Are consumers willing to wait for purchases to be delivered, will they pay for next-day delivery, or will they collect online purchases from a convenient pickup site?

In addition to providing round-the-clock global access to all kinds of products and services, B2C firms often attempt to build long-term relationships with their customers. Often, firms will make a special effort to make sure that the customer is satisfied and that problems, if any, are solved quickly. Most B2C firms, for example, have liberal return policies and often pay for returning merchandise that the customer does not like. Specialized software can also help build good customer relationships. Tracking the decisions and buying preferences when customers shop online, for instance, helps a B2C business provide suggestions for additional merchandise or services the customer may want to consider. In essence, this is Orbitz's (www.orbitz.com) online selling

business-to-consumer (or **B2C) model** a model used by firms that focus on conducting business with individual consumers

Table 14-2 Other Business Models That Perform Specialized e-Business Activities

Although modified versions of B2B or B2C, these business models perform specialized e-business activities to generate revenues.

Advertising e-business model	Advertisements that are displayed on a firm's website in return for a fee. Examples include pop-up and banner advertisements on search engines and other popular internet and social media sites.
Brokerage e-business model	Online marketplaces where buyers and sellers are brought together to facilitate an exchange of goods and services. One example is 1stDIBS (www.1stdibs.com), which provides a site for buying and selling furniture, lighting, home décor, antiques, jewelry, and fashion items.
Consumer-to-consumer model	Peer-to-peer software that allows individuals to share information over the internet. For example, Craigslist (www.craigslist.org) is a site where users can buy and sell all kinds of items.
Consumer to business model	Social media influencers, bloggers, or paid reviewers create content that promotes a company's products or services. In turn, the business pays either a predetermined dollar amount or a percentage of revenue for the promotion or information provided.
Subscription and pay-per-view e-business models	While some information may be free, detailed content is available only to users who pay a fee to gain access to a website. Examples include investment information provided by Morningstar (www.morningstar.com) and business research provided by Forrester Research, Inc. (www.forrester.com).

approach. By tracking and analyzing customer data, the online travel company can provide individualized service to its customers. Although a "little special attention" may increase the cost of doing business for a B2C firm, the customer's repeated purchases will repay the investment many times over.

Today, B2B and B2C models are the most popular business models for e-business. And yet, there are other business models that perform specialized e-business activities to generate revenues. Most of the business models described in Table 14-2 are modified versions of the B2B and B2C models.

✓ Concept Check

- What are the two-fundamental e-business models?
- Assume that you are the owner of a small company that produces outdoor-living furniture. Describe how you could use the B2C business model to sell your products to consumers.

14-7 The Future of the Internet, Social Media, and e-Business

Learning Objective

14-7 Identify the factors that will affect the future of the internet, social media, and e-business.

Since the beginning of commercial activity on the internet, developments in computer technology, social media, and e-business have been rapid, with spectacular successes such as Facebook, Amazon, Google, eBay, and Pinterest. However, success is not guaranteed just because it is a "technology" firm. Even firms with a promising idea must develop a business plan to turn the idea into a reality—and a successful business. Today, most firms involved in the internet, social media, and e-business use a very intelligent approach to the initial start-up phase and expansion and development. The long-term view held by the vast majority of analysts is that the internet, social media, and e-business will continue to expand to meet the needs of businesses and consumers.

14-7a Internet Growth Potential

To date, only about 65 percent of the global population uses the internet. In late 2020, estimates suggest that about 5.1 billion of the 7.9 billion people in the world use the internet.[26] In the United States, 297 million, or about 90 percent of the nation's population use the internet. With approximately 90 percent of the U.S. population already using the internet, potential growth in the United States is limited.[27] On the other hand, the number of internet users in the world's developing countries is expected to increase dramatically.

Although the number of global internet users is expected to increase, that's only part of the story. Perhaps the more important question is why people are using the internet. Primary reasons for using the internet include the ability to connect with other people, to obtain information, or to purchase a firm's products or services. Of particular interest to business firms is the growth of social media. For example, Facebook now has approximately 2.7 billion users worldwide. And because only about 34 percent of the world population currently uses Facebook, the number of Facebook users is expected to continue to increase for years to come.[28] In fact, the number of users for other social media sites, like TikTok, YouTube, Twitter, Instagram, and Pinterest, is also expected to increase.

Experts also predict that the number of companies using e-business to increase sales and reduce expenses will continue to increase. Firms that adapt existing business models to an online environment will continue to dominate development. Although products or services will continue to be sold in the traditional way, more and more products will be sold online.

JACOB LUND/SHUTTERSTOCK.COM

Even small businesses can sell merchandise online. While big retailers like Macy's, Walgreens, and Home Depot are increasing sales revenue from online sales, small businesses can also sell merchandise online. In fact, if a small business doesn't have a website, it's missing an opportunity to sell its products and services—especially unique or one-of-a-kind items.

14-7b Ethical and Legal Concerns

The social and legal concerns for the internet, social media, and e-business extend beyond those shared by all businesses. Essentially, the internet is a new "frontier" without borders and with little control by governments or other organizations.

Ethics and Social Responsibility Socially responsible and ethical behavior by individuals and businesses on the internet are major concerns. For example, an ethically questionable practice in cyberspace is the unauthorized use of information discovered through computerized tracking of users once they are connected to the internet. Essentially, a user may visit a website and unknowingly receive a small piece of software code called a **cookie**. This cookie can track where the user goes on the internet and measure how long the user stays at any particular website. Although this type of software may produce valuable customer information, it also can be viewed as an invasion of privacy, especially since users may not even be aware that their movements are being monitored. AT&T, Verizon, and other cell phone service providers use cookies to track an individual's browsing on mobile devices for advertising purposes. Shoppers with smartphones and a retailer's app on their smartphones may even be tracked when they enter a store. Once the store knows your location in the store, it can send texts or posts about discounts and merchandise that is on sale. Unlike the situation with cookies, however, shoppers must download the app to be tracked—but in exchange, they benefit by receiving personalized discounts.

Some firms also practice data mining. **Data mining** refers to the practice of searching through data records looking for useful information. Customer registration forms typically require a variety of information before a user is given access to a site. Based on an individual's information, data mining analysis can then provide what might be considered private and confidential information about individuals. For instance, assume an individual frequents a website that provides information about a life-threatening disease. If this information is sent to an insurance company, the

cookie a small piece of software sent by a website that tracks an individual's internet use

data mining the practice of searching through data records looking for useful information

KRYAZHEVA ALENA/SHUTTERSTOCK.COM

The hackers are coming! Today it's hard to turn on your computer or read an email without worrying if you will get a computer virus that will enable hackers to steal your personal and financial information and then use it for their own personal gain. In fact, identity and computer security is such a big problem that it has created a whole new industry—the software security industry.

company might refuse to insure this individual, thinking that there is a higher risk associated with someone who wants more information about this disease.

Besides the unauthorized use of cookies and tracking your location and your online behavior, there are several other threats to users' privacy and confidentiality. Monitoring an employee's computer usage may be intended to help employers police unauthorized internet use on company time. However, the same records can also give a firm the opportunity to observe what otherwise might be considered private and confidential information. A recent survey of over 300 employers by the American Management Association and the ePolicy Institute found that two thirds of employers monitor employee usage.[29] Today, legal experts suggest that, at the very least, employers need to disclose the level of surveillance to their employees and consider the corporate motivation for monitoring employees' behavior.

Ethics and Social Responsibility

California Ups the Ante on Privacy Protection

Data privacy is a major legal and ethical issue. In fact, 85 percent of U.S. internet users are concerned about how much information advertisers have collected about them. Even so, there is no comprehensive federal law that governs data privacy in the United States. Personal information, such as postal addresses, credit card numbers, email addresses, and browsing history, is a valuable marketing tool for companies, but the same information can open the door for identity thieves if it is not handled properly.

California took matters into its own hands with the California Consumer Privacy Act (CCPA). The act gave consumers more control over how their data is collected and used by businesses. The CCPA secured privacy rights for Californians, including the right to know what data is being collected and how it is used and shared, the right to have companies delete personal information (with some exceptions), the right to opt-out of having their personal information sold by one company to another, and the right to non-discrimination for exercising their CCPA rights.

California voters have also amended CCPA with the California Privacy Rights Act (CPRA). The CPRA amendment raised the privacy bar even higher. The original provisions put the burden on individuals to become aware of and protect their data instead of changing the way businesses collect, store, and use the data. The CPRA amendment created new requirements for businesses, such as limiting data retention, protecting data security, and minimizing data collection. It also strengthens accountability measures by requiring companies to conduct privacy risk assessments and cybersecurity audits.

Although the law was enacted in California, the importance of these laws goes beyond the state's boundaries because of the number of businesses that do business with California consumers. Also, the laws impact how marketers and ad publishers such as Facebook and Google personalize digital advertising. Finally, compliance will affect businesses financially when they hire data protection officers, implement new policies and procedures, train employees, modify processes, and monitor compliance.

Experts predict that California's privacy laws could become the national standard for data privacy, whether a federal law is created or not. Even if Congress enacts a national privacy law, it could face stiff opposition from Californians if the federal law does not meet or exceed the protections provided by the existing California law. The bottom line: Companies will need to find ways to help prevent identity theft and improve data protection now more than ever.

Sources: Based on information in Cameron F. Kerry and Caitlin Chin, "By Passing Proposition 24, California Voters up the Ante on Federal Privacy Law," *Brookings*, November 17, 2020, www.brookings.edu/blog/techtank/2020/11/17/by-passing-proposition-24-california-voters-up-the-ante-on-federal-privacy-law; Yory Wurmser, "Election Impact: Why the Passing of California's Prop 24 Matters for Marketers and What to Expect in 2021," *Business Insider*, November 4, 2020, https://www.businessinsider.com/why-passing-california-prop-24-matters-for-marketers-2020-11; State of California Department of Justice, "California Consumer Privacy Act (CCPA)," https://oag.ca.gov/privacy/ccpa.

Internet Crime Because the internet is often regarded as an unregulated frontier, both individuals and business users must be particularly aware of online risks and dangers. For example, a general term that describes software designed to infiltrate a computer system without the user's consent is **malware**. Malware is often based on the creator's criminal or malicious intent and can include computer viruses, spyware, deceptive adware, and other software capable of criminal activities. According to TechJury, more than 30,000 websites are hacked each day.[30] In fact, the increase in internet crime and the devastating effects of both malware and computer viruses have given rise to a software security industry.

In addition to the risk of computer viruses and hackers, identity theft is one of the most common computer crimes that impacts both individuals and business users. A recent report by the United States Federal Trade Commission (FTC) determined that more than 1.4 million Americans reported identity theft in one year.[31] In recent years, major government entities including the United States government and many businesses such as Microsoft, MGM Resorts, Walgreens, T-Mobile, and many others have been hacked by thieves who stole sensitive data from tens of millions of people.[32]

Most consumers are also concerned about fraud. Because the internet allows easy creation of websites, access from anywhere in the world, and anonymity for the creator, it is almost impossible to know with certainty that the website, organization, or individuals that you believe you are interacting with are what they seem. As always, caveat emptor ("let the buyer beware") is a good suggestion to follow whether on the internet or not.

14-7c Future Challenges for Computer Technology, Social Media, and e-Business

Today, more information and technology is available than ever before. Although individuals and business users may think we are at the point of information overload, the amount of information will only increase in the future. In order to obtain more information in the future, both business users and individuals must consider the cost of obtaining additional information and computer technology. In an effort to reduce expenses and improve accessibility, some companies and individuals are now using cloud computing. **Cloud computing** is a type of computer usage in which services stored on the internet are provided to users on a temporary basis. When cloud computing is used, a third party makes processing power, software applications, databases, and storage available for on-demand use from anywhere. Instead of running software and storing data on their employer's computer network or their individual computers, employees log onto the third party's system and use (and pay for) only the applications and data storage they actually need. Amazon Web Services (AWS), Microsoft, Google, IBM, Oracle, and many other firms in the technology industry offer cloud services. In addition to just cost, there are a number of external and internal factors that a business must consider.

Although the demands for a business are complex, it is useful to think of them as either *internal* or *external* forces that affect how a business uses computer technology. Internal forces are those that are closely associated with the actions and decisions taking place within a firm. As shown in Figure 14-8, typical internal forces include a firm's planning activities, organizational structure, human resources, management decisions, information database, and available financing. A shortage of skilled employees needed for a specialized project, for instance, can undermine a firm's ability to sell its services to clients. Unlike the external environmental forces affecting the firm, internal forces, such as this one, are more likely to be under the direct control of management. In this case, management can either hire the needed staff or choose to pass over a prospective project or outsource some of the work that is needed. In addition to the obvious internal factors that affect how a company operates, a growing number of firms are concerned about how their use of technology affects the environment. The term **green IT** is now used to describe all of a firm's activities to support a healthy environment

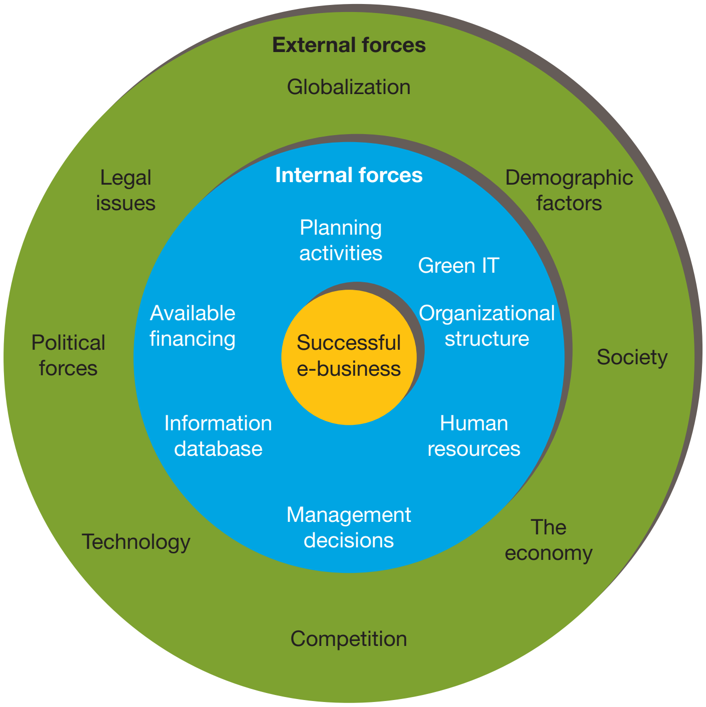
malware software designed to infiltrate a computer system without the user's consent

cloud computing a type of computer usage in which services stored on the internet are provided to users on a temporary basis

green IT a term used to describe all of a firm's activities to support a healthy environment and sustain the planet

Figure 14-8 **Internal and External Forces That Affect an e-Business**

Today, managers and employees of an e-business must respond to internal forces within the organization and external forces outside the organization.


External forces
Globalization
Legal issues
Demographic factors
Political forces
Society
Technology
The economy
Competition
Internal forces
Planning activities
Green IT
Available financing
Organizational structure
Information database
Human resources
Management decisions
Successful e-business

and sustain the planet. Many offices, for example, are reducing the amount of paper they use by storing data and information on computers.

In contrast, external forces affect a company's use of technology and originate outside the organization. These forces are unlikely to be controllable by a company. Instead, managers and employees of a company generally will react to these forces, attempting to shield the organization from any negative effects and finding ways to take advantage of opportunities in an ever-changing technology environment. The primary external forces affecting a company's use of technology include globalization, demographic, societal, economic, competitive, technological, and political and legal forces.

In this chapter, we have explored how both individuals and businesses use social media. We also examined how e-business and e-commerce are changing the way that firms do business. In Chapter 15, we examine a business firm's need for information and why accounting is a major source of information for business.

✓ Concept Check

- Experts predict that the internet will continue to expand along with related technologies. What effect will this expansion have on society, business, and individuals in the future?
- Give an example of an unethical use of computer technology by a business.
- What is the difference between internal and external forces that affect an e-business?

Summary

14-1 Examine why it is important for a business to use social media.

Millions of people of all ages use social media to interact with people and share ideas, personal information, and information about products and services. The primary reason for using social media is to stay in touch with family and friends. Other reasons include sharing photos or videos and obtaining information available on the internet. Just the sheer numbers of people using social media make using social media a top priority for business. Even though companies have used social media to share information about their products and services and improve customer service, many are still uncomfortable with this new method of communicating with customers because they do not have much control over what is said about their products or services.

14-2 Discuss how businesses use social media tools.

Companies use social media to connect with customers and stakeholders, provide customer service, provide information to customers, and engage customers in product development. To share social content (information about products and services), companies can use blogs, photos, videos, and podcasts. Before creating a media sharing site, managers and employees should consider who will create the photos, videos, and podcasts, how the content will be distributed, and how much it will cost. In addition, social media also enables shoppers to access opinions, recommendations, and referrals from others within and outside their own social circle. Rating and review sites are based on the idea that people trust the opinions of others when it comes to purchasing products and services.

14-3 Explain the business objectives for using social media.

Although its popularity is a recent phenomenon, many businesses are already using social media to achieve important goals and objectives. In fact, there are many ways for businesses to use social media to take advantage of business opportunities to build connections with other businesses and consumers. For example, businesses can use social media to build a community. Social media communities are social networks based on the relationships among people. Today, there are social communities for every interest, ethnic group, and lifestyle. Different types of communities include both forums and wikis. Other reasons for using social media include crisis and reputation management, listening to stakeholders, targeting customers, social media marketing, generating new product ideas, and recruiting employees.

14-4 Describe how businesses develop a social media plan.

Before developing a plan to use social media, it is important to determine how social media can improve the organization's overall performance and how the plan "fits" with a company's objectives and other promotional activities. Once it is determined how social media links to the company's other activities, the first step is to listen to what customers like and don't like about a company's products or services. Typically, the second step is to establish social media objectives that are specific, measurable, achievable, realistic, and oriented toward the future. After listening and establishing objectives, the third step is to identify the customer or market segment a business is trying to reach with a social media promotion. The fourth step is to select the social media tools that will be used to reach customers. While it is not necessary (or even advisable) to use all of the available tools, a company can use social media communities, blogs, photos, videos, and podcasts to reach potential or existing customers. Once social media tools have been identified, a company can implement and integrate the social media plan.

Both quantitative and qualitative measurements can be used to determine the effectiveness of a social media plan. Quantitative social media measurement consists of using numerical measurements. Key performance indicators (KPIs), for example, are generally quantitative measurements. Qualitative measurement is the process of accessing the opinions and beliefs about a brand and primarily uses sentiment analysis to categorize what is being said about a company. Because social media costs both time and money, it is important to maintain, update, and measure the success of a social media plan and make adjustments and changes if needed.

14-5 Explain the meaning of e-business.

e-Business, or electronic business, can be defined as the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs *through the facilities available on the internet*. e-Commerce is a part of e-business and usually refers only to buying and selling activities conducted online. The human, material, information, and financial resources that any business requires are highly specialized for e-business. In an effort to reduce the cost of e-business resources, many firms have turned to outsourcing. It is also possible to use mobile marketing to increase sales and profits.

Using e-business activities, it is possible to satisfy new customer needs created by the internet as well as traditional ones in unique ways. Meeting customer needs is especially important when an e-business is trying to earn profits by increasing sales. Each source of revenue flowing into the firm is referred to as a revenue stream. It is also possible to reduce expenses by using e-business activities.

14-6 Define the fundamental models of e-business.

e-Business models focus attention on the identity of a firm's customers. Firms that use the internet mainly to conduct business with other businesses generally are referred to as having a business-to-business, or B2B, model. When examining B2B firms, two clear types emerge. In the first type of B2B, the focus is simply on facilitating sales transactions between businesses. A second, more complex type of the B2B model involves a company and its suppliers. In contrast to the focus of the B2B model, firms such as Macy's, Walgreens, or Dick's Sporting Goods are focused on individual buyers and are thus referred to as having a business-to-consumer, or B2C, model. In a B2C situation, understanding how consumers behave online is critical to the firm's success. Successful B2C firms often make a special effort to build long-term relationships with their customers. While B2B and B2C models are the most popular e-business models, there are other models that perform specialized e-business activities to generate revenues (refer to Table 14-2).

14-7 Identify the factors that will affect the future of the internet, social media, and e-business.

Since the beginning of commercial activity on the internet, developments in computer technology, social media, and e-business have been rapid. Today firms with a promising idea must develop a business plan to turn an idea into a reality—and a successful business. The long-term view held by the vast majority of analysts is that use of the internet will continue to expand along with related technologies. Because approximately 90 percent of Americans now have access to the internet, potential growth is limited in the United States. On the other hand, only 5.1 billion of the 7.9 billion people in the world use the internet. Clearly, the number of internet users in the world's developing countries is expected to increase dramatically.

The future of computer technology and the internet will be influenced by advances in technology, the increasing popularity of social media, and the increasing use of e-business. Other factors, including ethics, social responsibility, and internet crime, will all impact the way that businesses and consumers use the internet. Although the environmental forces at work are complex, it is useful to think of them as either internal or external forces that affect how businesses use computer technology. Internal forces are those that are closely associated with the actions and decisions taking place within a firm. In contrast, external forces are those factors affecting an e-business originating outside an organization.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

social media (403)
hashtag (404)
social content sites (405)
blog (405)
media sharing sites (406)
influencer (407)
podcasts (407)
social media communities (408)
forum (408)
wiki (408)
social media community manager (409)
social media marketing (411)
inbound marketing (412)
crowdsourcing (413)
crowdfunding (416)
quantitative social media measurement (416)
key performance indicators (KPIs) (417)
qualitative social media measurement (417)
sentiment analysis (417)
e-business (or electronic business) (418)
e-commerce (418)
mobile marketing (418)
outsourcing (419)
revenue stream (421)
business model (422)
business-to-business (or B2B) model (422)
business-to-consumer (or B2C) model (423)
cookie (425)
data mining (425)
malware (427)
cloud computing (427)
green IT (427)

Discussion Questions

1. Given the fast pace of everyday life, most people often feel there is not enough time to do everything that needs to be done. Yet, people do find time to post text messages and personal information, photos, etc., on Facebook, Twitter, blogs, and other social media sites. Why do you think people are so fascinated with social media?
2. How can a small cosmetics wholesaler located in Jacksonville, Florida, use social media and e-business to increase its customer base, increase revenues, and reduce expenses?
3. Is outsourcing good for an e-business firm? The firm's employees? Explain your answers.
4. What distinguishes a B2B from a B2C e-business model?
5. Experts predict that the internet, social media, and e-business will continue to expand along with related computer technologies. What effect will this expansion have on how businesses (1) market and sell merchandise, (2) get paid for merchandise, and (3) deliver merchandise to customers?

Case 14

Target's Big Bet on Digital

When Target's CEO Brian Cornell announced the company would spend $7 billion for capital improvements and $1 billion more per year for operating costs to modernize operations for the digital age, investors weren't sold. "I had people shaking their heads," Cornell said. "You could see it." Target's stock price plummeted the day the announcement was made. Looking back now, Cornell knows the company made the right decision.

Target, one of the largest retailers in the United States, has spent billions on its stores and technology infrastructure.

The company reimagined its stores, built new, smaller stores in urban areas, and invested in technology and fulfillment capabilities. According to the CEO, the investment is paying off. All of these elements have worked together to drive growth, increase market share, and boost in-store and online traffic.

One of the most important initiatives was focused on remodeling existing stores and opening new small-format stores. In Target's smaller stores, the company reduced the amount of inventory and adopted a just-in-time approach to inventory management. The goal was simple: Deliver what the stores need, when they need it.

Target also invested in its supply chain in order to meet the needs of the "new" Target. For example, the company now utilizes artificial intelligence and robotics to support its warehouse teams. And, Target invested in creating backroom shipping and packaging centers in retail stores that act as distribution centers for online orders. Using its own retail stores as distribution centers gives it a significant advantage over Amazon. In-store and curbside pickup, for example, cost 90 percent less on average than fulfilling orders from a warehouse and then delivering the merchandise.

Target's $550 million acquisition of Shipt has also paid off. Shipt—a company known for offering same-day and next-day delivery—enables Target to go head-to-head against Amazon and other e-commerce retailers. It also acquired technology assets from Deliv—a same day delivery startup in California. Target is even testing the use of sort centers in areas with high delivery volume. The centers will be smaller and less expensive than Target's usual retail footprint and will be closer to customers. Target hopes that the use of sort centers will eliminate the need to sort packages at the store level and reduce its overall shipping costs.

These and other improvements have helped Target support in-store pickup, curbside delivery, and home delivery of online orders. In fact, it is now possible for "guests," as Target often calls its customers, throughout the United States and other countries to shop for all major product categories available from Target 24 hours a day, seven days a week. As an added bonus, technology has reduced the number of out-of-stock items and ultimately improved the customer's overall shopping experience.

Target's investments were well-timed. As a result of the COVID-19 pandemic and stay-at home mandates, Target's online business surged as shoppers turned to e-commerce to make purchases. In the first quarter of 2020, Target fulfilled more curbside deliveries than it did in the entire year of 2019. The company has also found that when customers shop online and use more of its delivery options, they ultimately spend more both online and in-store.

By investing in these new distribution strategies, Target is now able to compete against some big e-commerce companies. Although Target is now one of the top ten e-commerce businesses in the United States, the company has a long way to go to capture more market share. Amazon controls nearly 40 percent of U.S. retail e-commerce sales. Target, which has 1.2 percent market share, lags behind not only Amazon, but also Walmart, eBay, Apple, Home Depot, Wayfair, and Best Buy. While Target has taken some giant steps to increase sales online and in its brick-and-mortar stores, there's still room for growth as more and more customers shop online. Looking forward, Target executives will need to remember the old phrase—Where there's a will, there's a way.[33]

Questions

1. Why do you think Target's plan to spend $7 billion for capital improvements and an additional $1 billion more per year for operating costs initially worried investors? What do you believe investors think now?
2. Although many people think of Target as a big discount store that competes with Walmart, it has opened new, smaller stores that carry less inventory. What do you think is the driving force behind Target's smaller store concept?
3. Much of the information in this case describes Target's efforts to improve its supply chain. In your own words describe what the term "supply chain" means. How important is a firm's supply chain for a retailer like Target that has both in-store and online sales?

Building Skills for Career Success

1. Social Media Exercise

The purpose of the first part of this chapter is to introduce you to social media and its importance to business. After reading the chapter, choose a business that you either know something about, you want to start, or is the company you already work for.

Assignment

1. Develop a social media plan for that business using what you learned in this chapter.
2. What are the objectives of your social media plan?
3. What social media tools would you choose and why? How would you measure success?
4. Prepare a report that describes how this exercise has helped you understand the material in this chapter.

2. Building Team Skills

After graduating from college with a degree in marketing, your first job was working in the marketing department for a fast-food chain located in the southwestern part of the United States. After three years, you were promoted and became director of the chain's social media program. While monitoring posts about the company on Facebook and Twitter, you notice the following post from one of the firm's former employees.

> "Got fired today, but I was tired of serving low-quality food with expired expiration dates. Don't eat there or any of the chain's restaurants unless you want to get deathly ill."

To make matters worse, a couple of other employees who had recently been fired chimed in and made posts of a similar nature.

Assignment

1. Working in small teams, create a response that can be used to convince consumers that your company is committed to food freshness and quality and that these posts were made by employees who had been terminated.
2. Choose a spokesperson who will read your response to the rest of the class.
3. As a class, discuss the pros and cons of each response developed by each team.
4. Ask all members of the class to vote on the best response.
5. Finally, each team should prepare a report for the company's management that describes what happened and the response that was made to tell the company's side of this issue and restore consumer confidence in the firm's food products.

3. Researching Different Careers

Today, there are a wide assortment of career opportunities in companies that are involved in technology, social media, and e-business. In many cases, these firms want people with a fresh outlook on how technology, social media, and e-business companies can differentiate their products or services from those of other companies in the same industry. They often prefer individuals with new ideas and employees without preconceived notions about how to proceed. Website managers, designers, creative artists, and content specialists are just a few of the positions available. Many large online job sites, such as Indeed, LinkedIn, Monster.com, Glassdoor, and others, can help you to find out about employment opportunities and the special skills required for various jobs.

Assignment

1. Identify a website that provides information about careers in technology, social media, or e-business.
2. Summarize at least three positions that appear to be in high demand.
3. What are some of the special skills required to fill these jobs?
4. What salaries and benefits typically are associated with these positions?
5. Which job seems most appealing to you personally? Why?

Chapter

15

LIGHTFIELD STUDIOS/SHUTTERSTOCK.COM

Using Management and Accounting Information

Learning Objectives

Once you complete this chapter, you will be able to:

15-1 Examine how information can reduce risk when making a decision.

15-2 Discuss management's information requirements.

15-3 Outline the five functions of an information system.

15-4 Explain why accurate accounting information and audited financial statements are important.

15-5 Interpret a balance sheet.

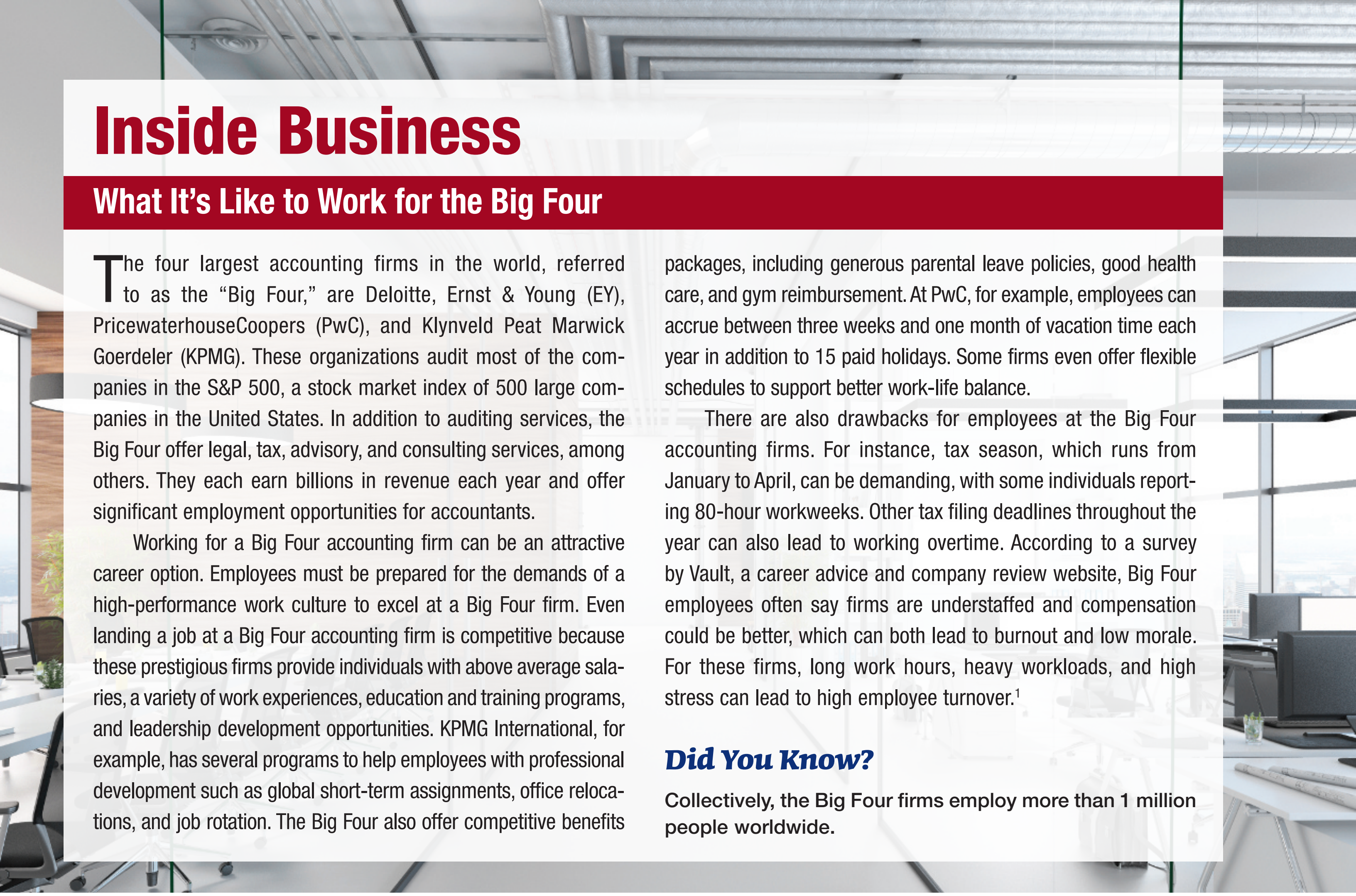
15-6 Interpret an income statement.

15-7 Describe business activities that affect a firm's cash flow.

15-8 Summarize how managers evaluate the financial health of a business.

Why Should You Care?

Question: How important is management and accounting information for a successful business?
Answer: It would be extremely difficult to manage even a small business without management and accounting information.



Inside Business

What It's Like to Work for the Big Four

The four largest accounting firms in the world, referred to as the "Big Four," are Deloitte, Ernst & Young (EY), PricewaterhouseCoopers (PwC), and Klynveld Peat Marwick Goerdeler (KPMG). These organizations audit most of the companies in the S&P 500, a stock market index of 500 large companies in the United States. In addition to auditing services, the Big Four offer legal, tax, advisory, and consulting services, among others. They each earn billions in revenue each year and offer significant employment opportunities for accountants.

Working for a Big Four accounting firm can be an attractive career option. Employees must be prepared for the demands of a high-performance work culture to excel at a Big Four firm. Even landing a job at a Big Four accounting firm is competitive because these prestigious firms provide individuals with above average salaries, a variety of work experiences, education and training programs, and leadership development opportunities. KPMG International, for example, has several programs to help employees with professional development such as global short-term assignments, office relocations, and job rotation. The Big Four also offer competitive benefits packages, including generous parental leave policies, good health care, and gym reimbursement. At PwC, for example, employees can accrue between three weeks and one month of vacation time each year in addition to 15 paid holidays. Some firms even offer flexible schedules to support better work-life balance.

There are also drawbacks for employees at the Big Four accounting firms. For instance, tax season, which runs from January to April, can be demanding, with some individuals reporting 80-hour workweeks. Other tax filing deadlines throughout the year can also lead to working overtime. According to a survey by Vault, a career advice and company review website, Big Four employees often say firms are understaffed and compensation could be better, which can both lead to burnout and low morale. For these firms, long work hours, heavy workloads, and high stress can lead to high employee turnover.[1]

Did You Know?

Collectively, the Big Four firms employ more than 1 million people worldwide.

Information and accounting—that's what this chapter is all about! We begin this chapter with information about how employees in each of the Big Four accounting firms help clients obtain the information they need to operate a business and improve management decisions. Because employees at a Big Four firm are responsible for generating and reporting the information and accounting reports their clients need, working conditions are sometimes stressful and hours may be long. On the other hand, employees at the Big Four are paid above average salaries and enjoy competitive benefits packages. Working for a Big Four accounting firm is just one option in the information and accounting industries. There are other career options where employees can help businesses, nonprofit organizations, and government entities use information and accounting to improve decision making.

In this chapter, we begin by describing why employees need information. The first three major sections in this chapter answer the following questions:

- How can information reduce risk when making a decision?
- What is a management information system?
- How do employees use a management information system?

Next, we look at why accounting information is important and careers in the accounting industry. Then we examine the basic accounting equation and the three most important financial statements: the balance sheet, the income statement, and the statement of cash flows. Finally, we take a look at how managers evaluate the firm's financial health.

15-1 How Can Information Reduce Risk When Making a Decision?

Learning Objective

15-1 Examine how information can reduce risk when making a decision.

Think back for a moment about the COVID-19 pandemic. For most people, one of the frustrations they faced was the inability to get information from reliable sources. While some information was based on facts, other information was based on opinions and conjecture without valid research to back up the statements some "experts" and politicians were making. Unfortunately, the lack of reliable information just added to the uncertainty of the pandemic and increased the risk of making poor decisions for both individuals and businesses.

As we noted in Chapter 1, information is one of the four major resources (along with material, human, and financial resources) managers must have to operate a business. Although a successful business uses all four resources efficiently, it is information that helps managers reduce risk when making a decision.

15-1a **Information and Risk**

To improve the decision-making process, the information used by individuals and business firms must be relevant. Using relevant information results in better decisions.

Relevant information → Better intelligence and knowledge → Better decisions

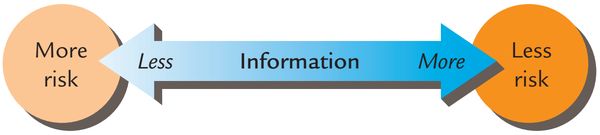
For businesses, better intelligence and knowledge that lead to better decisions are especially important because they can provide a *competitive edge* over competitors and improve a firm's *profits*.

Theoretically, with accurate and complete information, there is no risk whatsoever. On the other hand, a decision made without any information is a gamble. These two extreme situations are rare in business. For the most part, business decision makers see themselves located someplace between the extremes. As illustrated in Figure 15-1, when the amount of available information is high, there is less risk; when the amount of available information is low, there is more risk.

Think for a moment about Tesla's plan to produce a new all-electric sports car called the Model R. To make very important decisions, executives at Tesla relied on information. Without any information, Tesla executives might as well have made the decision by flipping a coin—heads we make the new Model R or tails we don't. For a decision this important that could impact both sales and profits for the entire company, executives began by gathering information from customers. Simply put: Did customers think a new all-electric, high performance roadster was a good idea? Customers also provided Tesla with additional information about the price that they were willing to pay for the car and about features and options they would like on a new vehicle. Information was also obtained from Tesla's own product engineers, production employees, marketing employees, and key executives. Only after all of the information was obtained and analyzed did Tesla make the decision to produce and market the Model R. Thus, information, when understood properly, produces knowledge and empowers managers and employees to make better decisions while also reducing the risk of making bad decisions.

Figure 15-1 **The Relationship Between Information and Risk**

When the amount of available information is high, managers tend to make better decisions. On the other hand, when the amount of information is low, there is a high risk of making a poor decision.



15-1b **Information Rules**

Marketing research continues to show that discounts influence people when buying consumer products. Simply put, if manufacturers and retailers lower prices on their products or services, their sales will increase. For example, if Best Buy lowers its price for a new Vizio 75-inch LED television from $1,699 to $1,499, the retailer will sell more televisions. This relationship between buyer behavior and price can be thought of as an information rule that will usually guide the marketing manager correctly. An information rule emerges when research confirms the same results each time that it studies the same or a similar set of circumstances.

Because of the volume of information they receive each day and their need to make decisions on a daily basis, businesspeople try to accumulate information rules to shorten the time they spend analyzing choices. Information rules are the "great simplifiers" for all decision makers. Managers and employees are continuously looking for new rules that can be put to good use and looking to discredit old ones that are no longer valid. This ongoing process is necessary because business conditions rarely stay the same for very long.

15-1c **The Difference Between Data and Information**

Many people use the terms *data* and *information* interchangeably, but the two differ in important ways. **Data** are numerical or verbal descriptions that usually result from some sort of measurement. Your current wage level, the amount of last year's after-tax profit for Google, and the current retail prices of Dell computers are all data. Most people think of data as being numerical only, but they can be nonnumerical as well. A description of an individual as a "tall, athletic person with short, dark hair" certainly would qualify as data.

data numerical or verbal descriptions that usually result from some sort of measurement

information data presented in a form that is useful for a specific purpose

Information is data presented in a form that is useful for a specific purpose. For example, Apple has earned a reputation as one of the best employers in the nation based on employee satisfaction, employee diversity and company culture, and its efforts to promote equal pay when female and male employees perform the same duties in the workplace. To verify that all employees receive the same pay for the same job, Apple has analyzed the salaries and bonuses that employees received over the last few years. To complete the analysis, human resources managers begin with data reported in computer printouts listing each worker employed by the firm, job classification, and each worker's current wages. Such printouts consist of data rather than information.

Now suppose that the manager uses a computer to graph the average wages paid to men and to women for each job classification. The result is information because the manager can use it to compare wages paid to women with those paid to men. If a gap exists, based on the information presented in the graph, management can address the problem. For a manager, information presented in a practical, useful form, such as a graph, simplifies the decision-making process.

RISK
ASSESSMENT

RAWPIXEL.COM/SHUTTERSTOCK.COM

Numbers and charts and more numbers and charts. In today's business world, there's so much data available that many managers and employees often believe they are looking for a needle in a haystack. To find just the right information, they often must dig deeper and use computers and graphics programs to process large amounts of data into the information they need to make informed decisions.

15-1d **Knowledge Management**

The average company maintains a great deal of data that can be transformed into information. Typical data include records pertaining to personnel, inventory, sales, expenses, manufacturing, and accounting. Often each type of data is stored in individual departments within

Technology and Innovation

The IRS Uses Artificial Intelligence and Technology to Improve Tax Collection

Data scientists at the IRS are using artificial intelligence (often referred to as AI) and increased technology to detect tax evasion, accounting fraud, and more. By translating tax regulations into source code and software, a group of computer scientists from the Massachusetts Institute of Technology was able to demonstrate how algorithms can detect tax evasion. Tax evasion occurs when an individual or business does not report income, takes more deductions than they are entitled, or are not paying taxes on income.

With a tight budget, the IRS has been slow to update its technology over the years. However, investing in AI and technology to fight tax evasion and accounting fraud may pay off since taxes are the primary source of income for the federal and state governments. As a result of the renewed interest in AI and technology, there are a number of ways the IRS is increasing the amount of taxes collected from tax cheaters. For example, the IRS is creating a tool for auditors that will spot questionable activities when auditing suspicious tax returns. Technology is also used to analyze internal and external data to identify people and businesses that are not filing tax returns. AI is even used to analyze the methods—letters, formal notices, or audits—that are most likely to convince taxpayers to pay back taxes and penalties.

AI is not without risks. Algorithmic "bias" in AI systems can exist when inaccurate data and information are used to build the algorithm. For example, an AI-powered auditing tool could provide inaccurate recommendations for auditing specific returns based on race, gender, or geographic location. It is also limited in that tax laws often have gray areas that are open to human interpretation, which could be challenging for machine intelligence to handle. Finally, U.S. taxpayers often find dealing with the IRS becomes even more impersonal when AI and technology are used.

At the same time the IRS is using AI and technology to fight tax fraud, tax preparers and accounting firms are using the same technology to boost tax refunds and minimize tax bills. In fact, all of the Big Four accounting firms (Deloitte, EY, PwC, and KPMG) use artificial intelligence tools for advising clients. The bottom line: AI and technology are already changing how taxes are collected and how individuals and businesses do tax planning.

Sources: Based on information in Richard Rubin, "AI Comes to the Tax Code," *The Wall Street Journal*, February 26, 2020, www.wsj.com/articles/ai-comes-to-the-tax-code-11582713000; Naveen Joshi, "How AI And Robotics Can Change Taxation," *Forbes*, January 9, 2020, www.forbes.com/sites/cognitiveworld/2020/01/09/how-ai-and-robotics-can-change-taxation; Lynnley Browning, "Computer Scientists Wield Artificial Intelligence to Battle Tax Evasion," *The New York Times*, October 9, 2015, www.nytimes.com/2015/10/10/business/computer-scientists-wield-artificial-intelligence-to-battle-tax-evasion.html.

an organization. However, the data can be used more effectively when they are organized into a database. A **database** is a single collection of data and information stored in one place that can be used by people throughout an organization to make decisions. Although databases are important, the way the data and information are used is even more important—and more valuable to the firm. As a result, management information experts now use the term **knowledge management (KM)** to describe a firm's procedures for generating, using, and sharing important data and information.

Making Smart Decisions How do managers and employees sort out relevant and useful information from spam, junk mail, and useless data? Today, different software applications can actually help to improve and speed the decision-making process for people at different levels within an organization. For example, a **decision-support system (DSS)** is a type of software program that provides relevant data and information to help a firm's employees make decisions. It also can be used to determine the effect of changing different variables and answer "what if"-type questions. For example, managers at D.R. Horton, one of the largest home builders

database a single collection of data and information stored in one place that can be used by people throughout an organization to make decisions

knowledge management (KM) a firm's procedures for generating, using, and sharing important data and information

decision-support system (DSS) a type of software program that provides relevant data and information to help a firm's employees make decisions

Table 15-1 Current Business Application Software Used to Improve Productivity

Word processing	Users can prepare and edit written documents and store them in the computer or on a memory device.
Desktop publishing	Users can combine text and graphics in professional reports, newsletters, and pamphlets.
Accounting	Users can record routine financial transactions and prepare financial reports at the end of the accounting period.
Database management	Users can electronically store large amounts of data and transform the data into information.
Graphics	Users can display and print pictures, drawings, charts, and diagrams.
Spreadsheets	Users can organize numerical data into a grid of rows and columns.

in the United States, can use a DSS to determine prices for new homes built in an upscale, luxury subdivision. By entering the number of homes that will be built along with different costs associated with land, labor, building materials, building permits, promotional costs, and all other costs, a DSS can help determine a base price for each new home. When a DSS is used, it is also possible to revise home prices if building costs change. For example, if the cost of materials or labor increases, a DSS can determine new home prices for each set of assumptions.

Another type of software program is an expert system that uses computers, software, data, and information to mimic the thinking of employees. Simply put, an **expert system** is a type of computer program that uses artificial intelligence to imitate a human's ability to think. Using a set of rules determined by employees, an expert system can analyze available data and information about a particular activity or problem. Based on the information supplied, the expert system then provides recommendations or suggests specific actions in order to help make decisions. Expert systems, for example, have been used to schedule manufacturing tasks, diagnose illnesses, determine credit limits for credit card customers, evaluate loan applications, and develop electronic games.

✓ Concept Check

- In your own words, describe how information reduces risk when you make a personal or work-related decision.
- What are information rules? How do they simplify the process of making decisions?
- What is the difference between data and information? Give an example of accounting data and accounting information.
- Describe how decision support systems, expert systems, and business application software can help improve employee productivity.

Business Application Software In addition to decision support and expert systems, a number of business software applications can improve both employee decision making and productivity. Early business application software typically performed a single function. Today, however, *integrated* software combines many functions in a single package. Integrated packages allow for the easy linking of text, numerical data, graphs, photographs, and even audiovisual clips. A business report prepared using the Microsoft Office package, for instance, can include all these components. From a career standpoint, you should realize that employers will assume that you possess, or will possess after training, a high degree of working comfort with several of the software applications described in Table 15-1.

Typically, data, information, databases, knowledge management, and computer software all become important parts of a firm's management information system.

expert system a type of computer program that uses artificial intelligence to imitate a human's ability to think

management information system (MIS) a system that provides managers and employees with the information they need to perform their jobs as effectively as possible

15-2 What Is a Management Information System?

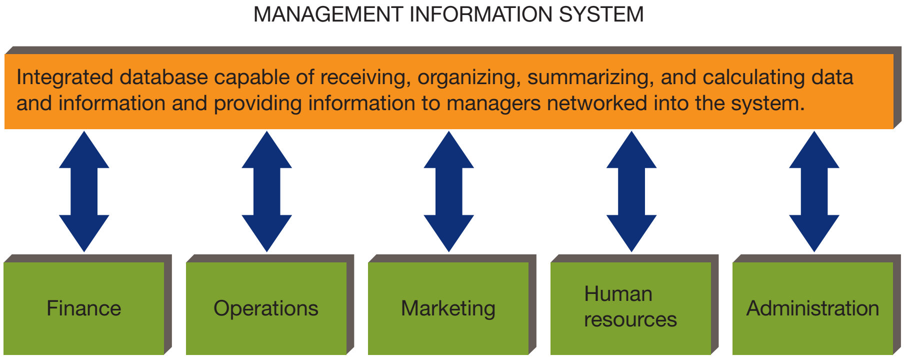
Learning Objective

15-2 Discuss management's information requirements.

A **management information system (MIS)** is a system that provides managers and employees with the information they need to perform their jobs as effectively as possible. The purpose of an MIS (sometimes referred to as an information technology system or simply an IT system) is to distribute timely and useful information from both internal and external sources to the managers and employees who need it.

Figure 15-2 **Management Information System (MIS)**

After an MIS is installed, employees and managers can get information directly from the MIS without having to go through other people in the organization.

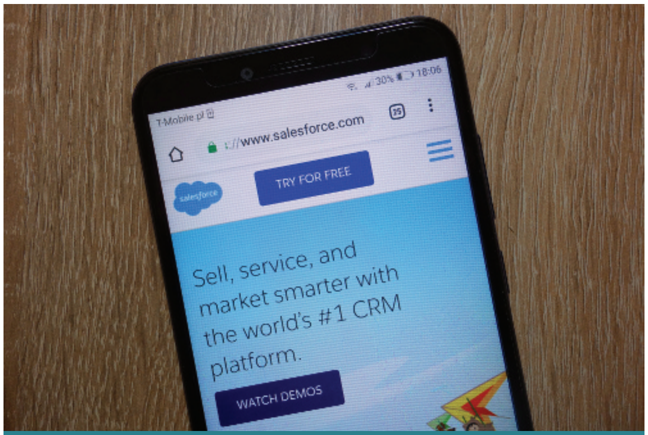

MANAGEMENT INFORMATION SYSTEM
Integrated database capable of receiving, organizing, summarizing, and calculating data and information and providing information to managers networked into the system.
Finance
Operations
Marketing
Human resources
Administration

15-2a **A Firm's Information Requirements**

Employees and managers have to plan for the future, implement their plans in the present, and evaluate results against what has been accomplished in the past. Of course, the specific types of information they need depend on their work area and on their level within the firm.

Today, many firms are organized into five areas of management: *finance, operations, marketing, human resources,* and *administration.* Managers in each of these areas need specific information in order to make decisions (refer to Figure 15-2).

- *Financial managers* are obviously most concerned with a firm's finances. They must ensure that the firm's managers and employees, lenders and suppliers, stockholders and potential investors, and government agencies have the information they need to measure the financial health of the firm.
- *Operations managers* are concerned with present and future sales levels; current inventory levels of resources, work in process, and finished goods; and the availability and cost of the resources required to produce goods and services.
- *Marketing managers* need to have detailed information about a firm's products and services and those offered by competitors. Such information includes sales projections, promotion and pricing strategies, products that competitors are test marketing, information concerning the firm's customers, and new and pending product legislation that may impact future sales.
- *Human resources managers* must be aware of anything that pertains to a firm's employees. Key examples include current wage levels and benefits packages both within the firm and in firms that compete for valuable employees and current legislation and court decisions that affect employment practices.
- *Administrative managers* are responsible for the overall management of the organization. Thus, they are concerned with the coordination of information—just as they are concerned with the coordination of material, human, and financial resources.


T-Mobile pl
://www.salesforce.com
salesforce
TRY FOR FREE
Sell, service, and market smarter with the world's #1 CRM platform.
WATCH DEMOS

PIOTR SWAT/SHUTTERSTOCK.COM

Question: What is customer relationship management (CRM) software? **The quick answer is that customer relationship management software is designed to enable a company and its salesforce to use data and information to track all interactions with potential and existing customers to increase sales and profits. While there are many companies that can provide CRM software, the world's leading source for help improving customer satisfaction and building customer loyalty is Salesforce.com located in San Francisco, California.**

Administrative managers must ensure information is used in a consistent manner throughout the firm. For example, in 2018, Airbus began constructing a new $300 million plant in Mobile, Alabama, to produce A220 passenger airplanes. In the initial planning stages, Airbus' administrative managers and employees wanted answers to many questions:

- Was the capacity of the plant consistent with marketing plans based on sales projections?
- Would human resources managers be able to recruit employees with the appropriate skills to staff the plant?
- Did sales projections indicate enough income to cover the expected cost of the plant?
- How long would it take before the plant could start building planes?

After much planning and construction, the production facility was completed, workers were hired, and the assembly process could begin. Eventually, new A220 aircraft were sold to Delta, JetBlue, Air Canada, and other airlines.

Also, administrative managers must make sure all managers and employees are able to use the information technology that is available. Certainly, this requires that all employees receive the skills training required to access the information. Finally, administrative managers must commit to the costs of updating the firm's MIS and providing additional training when necessary.

15-2b **Costs and Limits of the System**

Can employees, managers, and executives have too much information? The answer is yes. The truth is that each group needs relevant information that helps them make better decisions. And yet, too much information can lead to information overload. Another problem is the amount of worthless information, junk emails, and advertising that contribute to information overload. Unfortunately, there are many misuses of information technology that do nothing but rob employees of time that could be devoted to more productive activities.

In addition to lower employee productivity, the cost of computers, software, and related equipment can be staggering. One of the main goals of a firm's information technology officer (or IT department) is to make sure that a firm has the equipment necessary to provide information the employees need to make effective decisions—*at a reasonable cost.*

In reality, an MIS must be tailored to the needs of the organization it serves. In some firms, a tendency to save on initial costs may result in a system that is too small or overly simple. Such a system generally ends up serving only one or two management levels or a single department. Managers in other departments "give up" on the system as soon as they find that it cannot process their data, is unreliable, or is too slow to meet their information needs.

Almost as bad is an MIS that is too large or too complex for the organization. Unused capacity and complexity do nothing but increase the cost of owning and operating the system. In addition, a system that is difficult to use probably will not be used at all.

✓ Concept Check

- How do the information requirements of managers differ by management area?
- What happens if a business has a management information system that is too large?
- What happens if a business has a management information system that is too small?

15-3 How Do Employees Use a Management Information System?

Learning Objective

15-3 Outline the five functions of an information system.

To provide information, an MIS must perform five specific functions. It must (1) collect data, (2) store the data, (3) update the data, (4) process the data into information, and (5) present the information to users (refer to Figure 15-3).

15-3a **Step 1: Collecting Data**

A firm's employees, with the help of an MIS system, must gather the data and information needed to establish the firm's *database*. The database should include all past and current data that may be useful in managing the firm. Clearly, the data entered into the system must be *relevant* to the needs of the firm's employees. And perhaps most important, the data must be *accurate*. Irrelevant data are simply useless; inaccurate data can be disastrous. There are two data sources: *internal* and *external*.

Typically, most of the data gathered for an MIS come from internal sources. The most common internal sources of information are managers and employees, company records and reports, accounting data, and minutes of meetings.

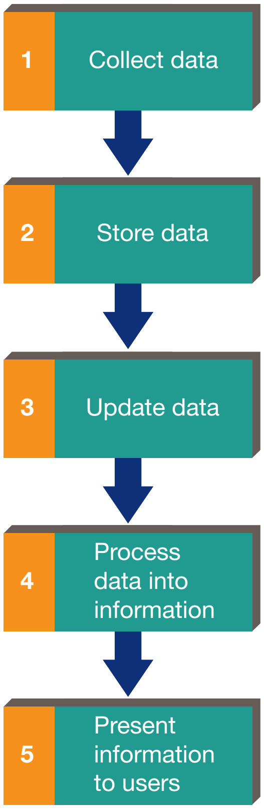
External sources of data include customers, suppliers, banks, trade and business publications, industry conferences, online computer services, lawyers, government sources, and firms that specialize in gathering marketing research for organizations.

Whether the source of the data is internal or external, always remember the following two cautions:

1. The cost of obtaining data from some external sources, such as marketing research firms, can be quite high.
2. Although computers generally do not make mistakes, the people who use them can make or cause errors. When data (or information) and your judgment disagree, always check the data.

Figure 15-3 Five Management Information System Functions

Every MIS must be tailored to the organization it serves and must perform the following five functions.



15-3b **Step 2: Storing Data**

An MIS must be capable of storing data until they are needed. Typically, the method chosen to store data depends on the size and needs of the organization. Small businesses may enter data and then store them directly on an employee's computer. Generally, medium-sized to large businesses store data in a larger computer system and provide access to employees through a management information system.

15-3c **Step 3: Updating Data**

Today, an MIS must be able to update stored data regularly to ensure that the information presented to managers and employees is accurate, complete, and up-to-date. The frequency with which the data are updated depends on how fast they change and how often they are used. When it is vital to have current data, updating may occur as soon as the new data are available. For example, Macy's, a national retailer that sells a wide range of merchandise including apparel, cosmetics, home furnishings, and other consumer goods, has cash registers that automatically transmit data on each item sold in each store and online to a central computer. The computer adjusts the store's inventory records accordingly. In addition to maintaining accurate inventory records, sales representatives can tell customers where they can obtain merchandise if the store where they are shopping is out of the merchandise they want or if the merchandise can be purchased online. Data may also be entered into a firm's data bank at certain intervals—every 24 hours, weekly, or monthly.

TANG YAN SONG/SHUTTERSTOCK.COM

15-3d **Step 4: Processing Data**

Some data are used in the form in which they are stored, whereas other data require processing to extract, highlight, or summarize the information they contain. **Data processing** is the transformation of data into a form that is useful for a specific purpose.

For verbal data, this processing consists mainly of extracting the pertinent material from storage and combining it into a report. Most financial data, however, are in the form of numbers—large groups of numbers, such as daily sales totals or production costs for a specific product. Fortunately, computer software can process large volumes of numbers quickly, and their contents can be summarized through the use of statistics. A **statistic** is a measure that summarizes a particular characteristic of an entire group of numbers.

15-3e **Step 5: Presenting Information**

An MIS must be capable of presenting information in a usable form. That is, the method of presentation—reports, graphs, charts, or tables, for example—must be appropriate for the information itself and for its intended use.

Business Reports Verbal information may be presented in list or paragraph form. Employees often are asked to prepare formal business reports. A typical business report includes:

- An introduction
- The body of the report
- The conclusions
- The recommendations

The *introduction,* which sets the stage for the remainder of the report, describes the problem to be studied in the report, identifies the research techniques that were used, and previews the material that will be presented in the report. The *body* of the report should objectively describe the facts that were discovered in the process of completing the report. The *conclusions* are statements of fact that describe the findings contained in the report. The *recommendations* section presents suggestions on how the problem might be solved. Like the conclusions, the recommendations should be specific, practical, and based on the evidence contained in the report.

Visual Displays and Tables A visual display can also be used to present information and may be a diagram that represents several items of information in a manner that makes comparison easier. Figure 15-4 illustrates examples of visual displays including graphs, bar charts, and pie charts generated by a computer.

A tabular display is used to present verbal or numerical information in columns and rows. It is most useful in presenting information about two or more related variables. A table, for example, can be used to illustrate the number of salespeople in each region of the country, sales for different types of products, and total sales for all products

data processing the transformation of data into a form that is useful for a specific purpose

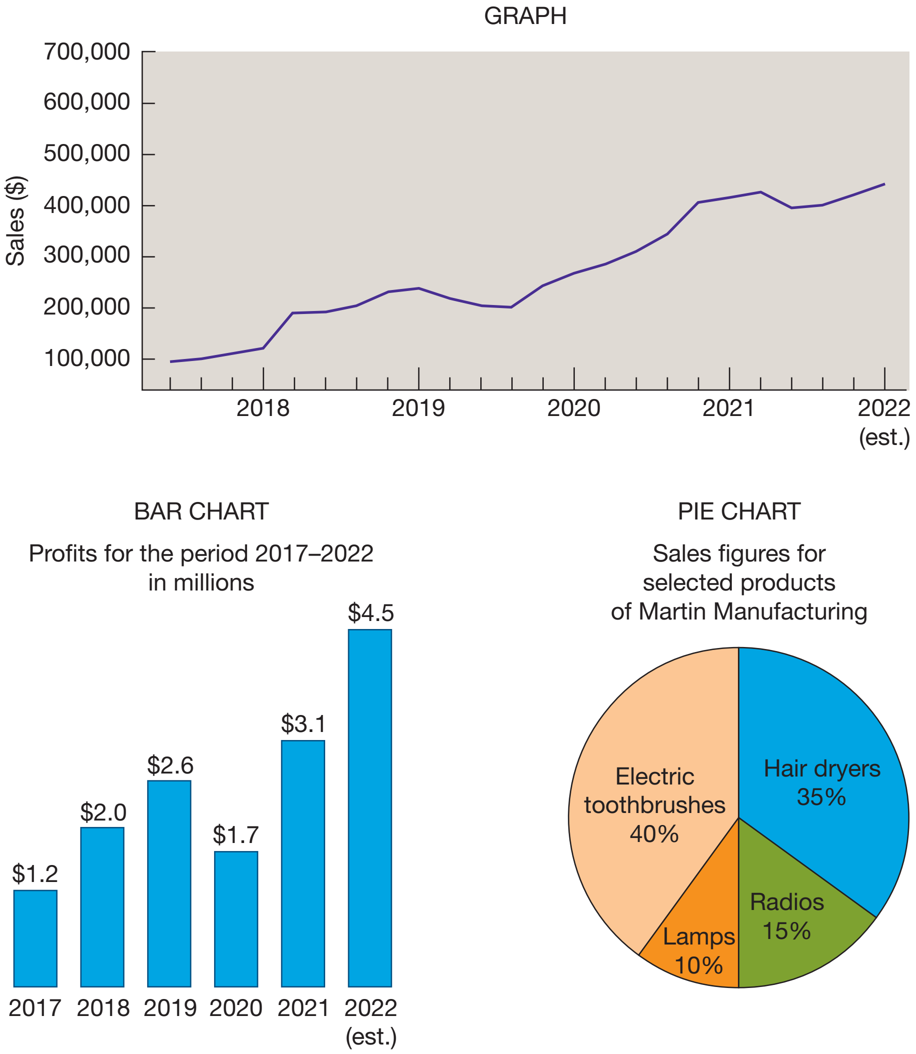
statistic a measure that summarizes a particular characteristic of an entire group of numbers

FIZKES/SHUTTERSTOCK.COM

With the right information and a computer, preparing a report may be easier than you think! The decision makers in a successful business need information that is relevant, accurate, up-to-date, *and* accessible. To make information more accessible, employees are often asked to prepare a report that summarizes information in a more concise form. This same information may even be easier to understand if the report contains graphs, charts, or tables—all features that are easily created using computer software.

Figure 15-4 Typical Visual Displays Used in Business Presentations

Visual displays help businesspeople present information in a form that can be understood easily.



(refer to Table 15-2). Tabular displays generally have less impact than visual displays. However, displaying the information that could be contained in a multicolumn table such as the one shown in Table 15-2 would require several bar or pie charts.

Table 15-2 Typical Four-Column Table Used in Business Presentations

Tables are most useful for displaying information about two or more variables. All-Star Technology Projected Sales

Section of the Country	Number of Salespeople	Consumer Electronic Products ($)	Industrial Electronic Components ($)
Eastern territory	15	1,500,000	3,500,000
Midwestern territory	20	2,000,000	5,000,000
Western territory	10	1,000,000	4,000,000
TOTAL	45	4,500,000	12,500,000

✓ Concept Check

- List the five functions of an MIS.
- What are the components of a typical business report?
- What types of information could be illustrated in a visual display? In a tabular display?

15-4 Why Accounting Information Is Important

Learning Objective

15-4 Explain why accurate accounting information and audited financial statements are important.

In order to obtain needed information, firms use an MIS like the one described in the first part of this chapter. Executives, managers, and employees also rely on the firm's accounting system to provide needed financial information. **Accounting** is the process of systematically collecting, analyzing, and reporting financial information. Just for a moment, think about the following three questions:

1. Did Coca-Cola's sales revenue increase last year?
2. How much federal income tax did Walmart pay last year?
3. How much cash does Intel have that can be used to acquire other business firms and pay its debts?

In each case, the firm's accountants and its accounting system provide the answers to these questions and many others. Although accounting information can be used to answer questions about what has happened in the past, it can also be used to help make decisions about the future.

Because the information provided by a firm's accountants and its accounting system is so important, managers and employees, investors, financial analysts, lenders, suppliers, government agencies, and other interested groups must be able to "trust the numbers." To improve the accuracy of a firm's accounting information and its financial statements, businesses rely on audits conducted by accountants employed by public accounting firms.

15-4a Why Audited Financial Statements Are Important

An **audit** is an examination of a company's financial statements and the accounting practices that produced them. The purpose of an audit is to make sure that a firm's financial statements have been prepared in accordance with **generally accepted accounting principles (GAAPs)**. GAAPs have been developed to provide an accepted set of guidelines and practices for U.S. companies reporting financial information and the accounting profession. At the time of publication, the Financial Accounting Standards Board (FASB), which establishes and improves accounting standards for U.S. companies, is working toward establishing a new set of standards that combines GAAPs with the International Financial Reporting Standards (IFRS) to create one set of accounting standards that can be used by both U.S. and multinational firms. For multinational firms like Johnson & Johnson, Royal Dutch Shell, ExxonMobil, Walmart, and Toyota, the benefits of global accounting standards are huge because preparing financial statements and accounting records that meet global standards saves both time and money.

If accountants determine that a firm's financial statements present financial information fairly and conform to GAAPs, then they will issue the following statement:

> *In our opinion, the financial statements ... present fairly, in all material respects the financial position of the company ... in conformity with generally accepted accounting principles.*

Although an audit and the resulting report do not *guarantee* that a company has not "cooked" the books, it does imply that, on the whole, the company has followed GAAPs. Also, it should be noted that without the audit function and GAAPs, there would be very little oversight or supervision. The reliability of a firm's financial statements and its accounting records would drop quickly, and firms would find it difficult to obtain debt financing, use credit to purchase goods and services from suppliers, find investor financing, or prepare documents requested by government agencies.

accounting the process of systematically collecting, analyzing, and reporting financial information

audit an examination of a company's financial statements and the accounting practices that produced them

generally accepted accounting principles (GAAPs) an accepted set of guidelines and practices for U.S. companies reporting financial information and for the accounting profession

Ethics and Social Responsibility

KPMG Caught in Widespread Cheating Scandal

KPMG, one of the Big Four accounting firms, was caught engaging in a series of unethical behaviors. First, KPMG stole regulatory information to cheat on audit inspections. The company, which employs more than 219,000 individuals worldwide and earns more than $29 billion annually, improperly received inspection information from the Public Company Accounting Oversight Board (PCAOB). Allegedly, KPMG obtained information about which of its audits the PCAOB would review from a former PCAOB staff member it hired. This behavior continued as other PCAOB staffers sought employment at KPMG. This resulted in $50 million in fines.

Then, during the Securities and Exchange Commission (SEC) investigation of this scandal, it was uncovered that KPMG auditors, including some senior partners responsible for public company audits, engaged in sharing questions and answers for internal exams related to mandatory ethics, integrity, and compliance training. As part of a settlement with the SEC, three former KPMG audit partners were suspended from accounting activities, including financial reporting and auditing for public companies. As a result of the cheating scandal, KPMG took steps to strengthen its governance and compliance program.

Ethics and compliance programs alone are not enough to ensure misconduct will not occur. Employee training, behavior monitoring, and ongoing reevaluation of the ethics program and business practices are also required. Additionally, management is responsible for setting the tone at the top of the organization and creating an ethical atmosphere. The fact that executives and senior partners were involved in these scandals suggests KPMG could have a more widespread culture problem on its hands.

Sources: Based on information in KPMG, "KPMG Fast Facts," March 18, 2021, https://home.kpmg/us/en/home/about/kpmg-fast-facts.html; Francine McKenna, "The KPMG Cheating Scandal Was Much More Widespread Than Originally Thought," *Market Watch*, June 18, 2019, www.marketwatch.com/story/the-kpmg-cheating-scandal-was-much-more-widespread-than-originally-thought-2019-06-18; Aaron Nicodemus, "KPMG Audit Partners Settle Test Cheating Allegations," *Compliance Week*, May 19, 2020, www.complianceweek.com/accounting-and-auditing/kpmg-audit-partners-settle-test-cheating-allegations/28942.article.

15-4b Accounting Fraud, Ethical Behavior, and Reform

Question: Why did Celadon, one of the largest trucking companies in the United States, file for bankruptcy?

Answer: While there are other factors, accounting fraud was a major factor behind the bankruptcy filing.[2]

Celadon's problems began when the company used a complex accounting scheme to inflate the values for older trucking equipment. The Securities and Exchange Commission (SEC) charged Celadon, the president and chief operating officer, and the chief financial officer with violating various antifraud provisions of the federal securities laws, lying to auditors, and "cooking" the books to inflate the amounts reported for income and earnings per share. Eventually, Celadon agreed to pay a $42.2 million fine to settle the SEC case. Because of the accounting problems, the SEC lawsuit, and a downturn in the trucking industry, the company eventually filed bankruptcy in December 2019. On March 31, 2021—15 months after the initial bankruptcy filing—the Celadon case was finally closed.

Unfortunately, the ones hurt when companies (and their executives and accountants) report inaccurate or misleading accounting information often are not the high-paid corporate executives. In many cases, it's the employees who lose their jobs, as well as the money they invested in the company's retirement program, if the company files for bankruptcy. In addition, investors, lenders, and suppliers who relied on fraudulent accounting information in order to make a decision to invest in or lend money to the company also usually experience a loss.

Today, much of the pressure on corporate executives to "cook" the books is driven by the desire to look good to Wall Street analysts and investors. Recently, the SEC charged Illinois-based Power Solutions, and its former CEO and two other former executives with inflating financial results by almost $25 million. All three executives were charged with securities fraud by the SEC and the Department of Justice. The company agreed to pay $1.7 million to settle the SEC charges. The motivation behind the accounting fraud was to meet sales and revenue projections.[3] If a company reports sales and profit figures that are higher than expected, the company's stock value can increase dramatically. On the other hand, if a company, like Power Solutions, reports sales and revenue that are lower than expected, its stock can drop. Greed—especially when executive salaries and bonuses are tied to a company's stock value—is another factor that can lead some corporate executives to use unethical accounting methods to inflate a firm's sales revenues and profit amount.

FIZKES/SHUTTERSTOCK.COM

Ouch—an audit! The word audit only contains five letters, but this word often provokes a deep fear in most people including business executives and employees. The audit process for a business is to make sure the company has followed generally accepted accounting principles (GAAPs) when it prepared its financial statements and accounting information. While an audit does not guarantee a company hasn't "cooked" the books, it does provide assurance it has used GAAPs to report financial information.

To help ensure that corporate financial information is accurate and to prevent the type of accounting scandals that have occurred in the past, Congress enacted the Sarbanes-Oxley Act. Key components include the following:[4]

- The SEC is required to establish a full-time five-member public company accounting oversight board.
- Executive and financial officers are responsible for accuracy, documentation, and submission of financial reports and are liable for intentional violations of securities reporting requirements.
- Accounting firms are prohibited from providing many types of non-audit and consulting services to the companies they audit.
- Auditors or accountants must maintain financial documents and audit work papers. The time period is usually five to seven years depending on the type of document.
- Auditors, accountants, and employees can be imprisoned for up to 20 years and subject to fines for destroying financial documents and for willful violations of the securities laws.
- A public corporation must change its lead auditing firm every five years.
- There is added protection for whistle-blowers who report violations of the Sarbanes-Oxley Act.

Although most people welcome the Sarbanes-Oxley Act, complex rules make compliance more expensive and time-consuming for corporate management and more difficult for accounting firms. Yet, most people agree that the cost of compliance is justified.

15-4c Different Types of Accounting

Although many people think that all accountants do the same tasks, there are special areas of expertise within the accounting industry. In fact, accounting is usually broken down into two broad categories: managerial and financial.

managerial accounting provides managers and employees with the information needed to make decisions about a firm's financing, investing, marketing, and operating activities

Managerial accounting provides managers and employees within the organization with the information needed to make decisions about a firm's financing, investing, marketing, and operating activities. By using managerial accounting information, both managers and employees can evaluate how well they have done in the past and what they can expect in the future.

Financial accounting, on the other hand, generates financial statements and reports for interested people outside of an organization. Typically, investors, financial analysts, bankers, lenders, suppliers, government agencies, and other interested groups use the information provided by financial accounting to determine how well a business firm has achieved its goals. In addition to managerial and financial accounting, additional special areas of accounting include the following:

- *Cost accounting*—determining the cost of producing specific products or services
- *Tax accounting*—planning tax strategy and preparing tax returns for firms or individuals
- *Government accounting*—providing basic accounting services to ensure that tax revenues are collected and used to meet the goals of state, local, and federal agencies
- *Not-for-profit accounting*—helping not-for-profit organizations to account for all donations and expenditures

ACCOUNTING
Taxes
Personal
Financial statements
Small Business
Bookkeeping
Payroll

MICHAEL D BROWN/SHUTTERSTOCK.COM

Ever wonder what an accountant does during a typical workday? While activities vary, there is a good chance an accountant is preparing information about the items listed in this photo that can be reported to the people who need it—employees, managers, business owners, and individuals—to improve their financial decisions.

15-4d **Careers in Accounting**

Accounting can be an exciting and rewarding career. To be successful in the accounting industry, employees must:

- be responsible, honest, and ethical;
- have a strong background in financial management;
- know how to use a computer and software to process data into accounting information; and
- be able to communicate with people who need accounting information.

According to the *Occupational Outlook Handbook*, published by the Department of Labor, job opportunities for accountants, as well as auditors in the accounting area, are expected to experience a 4 percent increase by the year 2029.[5] And more good news: Salaries for employees in the accounting industry are often higher than the salaries for other industries.

What is the typical day like for accountants? While each day may be different than the next and depending on if they are self-employed, work for a business, or work for an accounting firm, accountants typically:

- assist employees, managers, and owners to improve financial decisions;
- suggest ways to reduce costs, increase revenues, and improve profits;
- ensure the business is using generally accepted accounting procedures;
- prepare financial statements at the end of an accounting period;
- calculate the amount of taxes owed, prepare tax returns, and ensure that taxes are paid properly and on time; and
- organize and maintain financial records and make sure the firm's bills are paid on time.

Today, accountants generally are classified as either private accountants or public accountants. A *private accountant* is employed by a specific organization. On the other hand, a *public accountant* works on a fee basis for clients and may be self-employed or be the employee of an accounting firm. Accounting firms range

financial accounting generates financial statements and reports for interested people outside an organization

Exploring Careers

Forensic Accounting Is on the Rise

Why do people become forensic accountants? The answer: It is an exciting career path that is growing and combines accounting, auditing, and investigative skills to analyze financial documents in search of fraudulent activities and financial misconduct. Simply put, forensic accountants function as detectives. Their findings and analysis are often used in legal proceedings to prosecute people guilty of accounting fraud or even criminal activities. The origins of forensic accounting date back to the 1930s with the publishing of *Principles of Criminology*, which described the so-called fraud triangle. The triangle outlines how opportunity, incentive, and rationalization contribute to the risk of fraud.

Today, the demand for forensic accounting is on the rise. To comply with current auditing standards and laws such as the Sarbanes-Oxley Act, many accounting and auditing firms are expanding their fraud-detection services. Additionally, several federal government agencies use forensic accountants to tackle complex investigative work related to corporate fraud, healthcare fraud, securities fraud, and more. The analysis provided by forensic accountants can even be applied to areas such as cybercrime, public corruption, and counterterrorism. For example, the Federal Bureau of Investigation (FBI) hires forensic accountants to follow money trails of criminal activity and national security threats by acquiring, organizing, analyzing, and reporting financial data.

The duties of a forensic accountant can include gathering evidence, investigating financial documents, examining business records, working alongside law enforcement, and testifying in court. These duties require strong analytical and reasoning skills, the ability to effectively communicate, and a skeptical mind. The Association of Certified Fraud Examiners (ACFE), which is the world's largest anti-fraud organization, certifies accounting professionals as certified fraud examiners (CFEs). ACFE has grown to more than 90,000 members with the goal of reducing business fraud around the world and improving public confidence within the profession of accounting.

Sources: Based on information in Association of Certified Fraud Examiners, "About ACFE," March 16, 2021, www.acfe.com/about-the-acfe.aspx; FBI Jobs, "Forensic Accountants," March 15, 2021, www.fbijobs.gov/career-paths/forensic-accountant; Yigal Rechtman, "The Past, Present, and Future of Forensic Accounting," *The CPA Journal*, April 2020, www.cpajournal.com/2020/04/10/the-past-present-and-future-of-forensic-accounting.

---

in size from one-person operations to huge international firms with hundreds of accounting partners and thousands of employees.

Typically, public accounting firms include on their staffs at least one **certified public accountant (CPA)**, an individual who has met state requirements for accounting education and experience and has passed a rigorous accounting examination. More information about general requirements and the CPA profession can be obtained by contacting the American Institute of CPAs (AICPA) at www.aicpa.org. Be sure and click on the tab "Career Guidance" for information about how to become a CPA.

✓ Concept Check

- What purpose do audits and GAAPs serve in today's business world?
- How do the major provisions of the Sarbanes-Oxley Act affect a public company's audit procedures?
- Based on the information in this section, would you choose accounting as a career?

15-5 The Accounting Equation and the Balance Sheet

Learning Objective

15-5 Interpret a balance sheet.

At the beginning of this chapter, *information* was defined as data presented in a form that is useful for a specific purpose. Now, we examine how financial *data* are transformed into financial *information* and reported on three very important financial statements—the balance sheet, income statement, and statement of cash flows. We begin by describing why the fundamental accounting equation is the basis for a firm's balance sheet.

15-5a The Accounting Equation

The accounting equation is a simple statement that forms the basis for the accounting process. This equation shows the relationship between a firm's assets, liabilities, and owners' equity.

- **Assets** are the resources a business owns—cash, inventory, equipment, and real estate.
- **Liabilities** are the firm's debts—borrowed money it owes to others that must be repaid.
- **Owners' equity** is the difference between total assets and total liabilities—what would be left for the owners if the firm's assets were sold and the money used to pay off its liabilities.

The relationship between assets, liabilities, and owners' equity is shown by the following **accounting equation**:

Assets = Liabilities + Owners' equity

Whether a business is a small corner grocery store or a global giant like Procter & Gamble or Amazon, the total dollar amount for assets must equal the sum of its liabilities and owners' equity. To use this equation, a firm's accountants must record raw data—that is, the firm's day-to-day financial transactions—using the double-entry system of bookkeeping. The **double-entry bookkeeping system** is a system in which each financial transaction is recorded as two separate accounting entries to maintain the balance shown in the accounting equation. At the end of a specific accounting period, all of the financial transactions can now be summarized in the firm's financial statements. The form of the financial statements is pretty much the same for all businesses, from a neighborhood video store or small dry cleaner to giant corporations such as Home Depot, Boeing, and FedEx. A firm's financial statements are prepared at least once a year and included in the firm's annual report. An **annual report** is a report distributed to stockholders and other interested parties that describes a firm's operating activities and its financial condition. Because the information contained in financial statements can help executives and employees manage a business and plan for the future, most firms also have financial statements prepared semiannually, quarterly, or monthly.

certified public accountant (CPA) an individual who has met state requirements for accounting education and experience and has passed a rigorous accounting examination

assets the resources that a business owns

liabilities a firm's debts and obligations

owners' equity the difference between a firm's assets and its liabilities

accounting equation the basis for the accounting process: *Assets = Liabilities + Owners' equity*

double-entry bookkeeping system a system in which each financial transaction is recorded as two separate accounting entries to maintain the balance shown in the accounting equation

annual report a report distributed to stockholders and other interested parties that describes the firm's operating activities and its financial condition

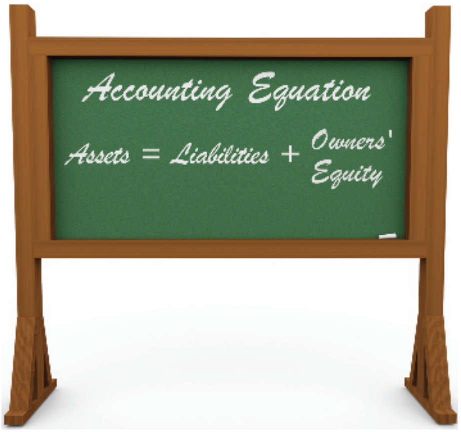
balance sheet (or **statement of financial position)** a summary of the dollar amounts of a firm's assets, liabilities, and owners' equity accounts at the end of a specific accounting period

15-5b The Balance Sheet

Question: *Where could you find the total amount of assets, liabilities, and owners' equity for The Hershey Company?*

Answer: The firm's balance sheet.

A **balance sheet** (sometimes referred to as a **statement of financial position**) is a summary of the dollar amounts of a firm's assets, liabilities, and owners' equity accounts at the end of a specific accounting period. The balance sheet must demonstrate that assets are equal to liabilities plus owners' equity, and the accounting equation is still in balance. Most people think of a balance sheet as a statement that reports the financial condition of a business firm such as The Hershey Company, but balance sheets apply to individuals, too. For example, Marty Campbell graduated from college three years ago and now is employed as a sales representative for a medical supply firm. After going to work, he established a checking and savings account and purchased an automobile, stereo, television, and furniture for his apartment. Marty paid cash for some purchases, but he had to borrow money to pay for the larger ones. Figure 15-5 shows Marty's current personal balance sheet. Marty Campbell's assets total $26,500, and his liabilities amount to $10,000. Although the difference between total assets and total liabilities is referred to as *owners' equity* or



RIBAH/SHUTTERSTOCK.COM

Figure 15-5 Personal Balance Sheet

Often, individuals determine their net worth by subtracting the value of their liabilities from the value of their assets.

Marty Campbell
Personal Balance Sheet
December 31, 20XX

ASSETS			LIABILITIES		
Cash	$ 2,500		Automobile loan	$ 9,500	
Savings account	5,000		Credit card balance	500	
Automobile	15,000		TOTAL LIABILITIES		$10,000
Stereo	1,000				
Television	500				
Furniture	2,500		NET WORTH (Owners' Equity)		16,500
TOTAL ASSETS		$26,500	TOTAL LIABILITIES AND NET WORTH		$26,500

stockholders' equity for a business, it is normally called *net worth* for an individual. As reported on Marty's personal balance sheet, net worth is $16,500. The total assets ($26,500) and the total liabilities *plus* net worth ($26,500) are equal. Thus, the accounting equation (Assets = Liabilities + Owners' equity) is still in balance.

Figure 15-6 shows the balance sheet for Northeast Art Supply, a small wholesale business that sells picture frames, paints, canvases, and other artists' supplies

Figure 15-6 Business Balance Sheet

A balance sheet (sometimes referred to as a statement of financial position) summarizes a firm's assets, liabilities, and owners' equity. Note that assets ($340,000) equal liabilities plus owners' equity ($340,000) and the accounting equation is still in balance.

NORTHEAST ART SUPPLY, INC.

Balance Sheet
December 31, 20XX

ASSETS

Current assets			
Cash		$ 59,000	
Marketable securities		10,000	
Accounts receivable	$ 40,000		
Less allowance for doubtful accounts	2,000	38,000	
Notes receivable		32,000	
Merchandise inventory		41,000	
Prepaid expenses		2,000	
Total current assets			$182,000
Fixed assets			
Delivery equipment	$110,000		
Less accumulated depreciation	20,000	$ 90,000	
Furniture and store equipment	$62,000		
Less accumulated depreciation	15,000	47,000	
Total fixed assets			137,000
Intangible assets			
Patents		$ 21,000	
Total intangible assets			21,000
TOTAL ASSETS			$340,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities			
Accounts payable	$ 35,000		
Notes payable	25,675		
Salaries payable	4,000		
Taxes payable	5,325		
Total current liabilities		$ 70,000	
Long-term liabilities			
Mortgage payable on store equipment	$ 40,000		
Total long-term liabilities		$ 40,000	
TOTAL LIABILITIES			$110,000
Stockholders' equity			
Common stock (25,000×$6)		$ 150,000	
Retained earnings		80,000	
TOTAL OWNERS' EQUITY			230,000
TOTAL LIABILITIES AND OWNERS' EQUITY			$340,000

to retailers in New England. Let's work through the different accounts in Figure 15-6.

15-5c **Assets**

On a balance sheet, assets are listed in order from the *most liquid* to the *least liquid*. The **liquidity** of an asset is the ease with which it can be converted into cash.

Current Assets **Current assets** are assets that can be converted quickly into cash or that will be used in one year or less. Because cash is the most liquid asset, it is listed first. Next are *marketable securities*—stocks, bonds, and other investments—that can be converted into cash in a matter of days.

Next are the firm's receivables. Its *accounts receivable,* which result from allowing customers to make credit purchases, generally are paid within 30 to 60 days. However, the firm expects that some of these debts will not be collected. Thus, it has reduced its accounts receivables by a 5 percent *allowance for doubtful accounts*. The firm's *notes receivable* are receivables for which customers have signed promissory notes. They generally are repaid over a longer period of time than the firm's accounts receivable.

Northeast's *merchandise inventory* represents the value of goods on hand for sale to customers. Since Northeast Art Supply is a wholesale business, the inventory listed in Figure 15-6 represents finished goods ready for sale to retailers. For a manufacturing firm, inventory also may represent raw materials or work that has been partially completed but requires further processing.

Northeast Art's last current asset is *prepaid expenses,* which are assets that have been paid for in advance but have not yet been used. An example is insurance premiums. They are usually paid at the beginning of the policy year. The unused portion (say, for the last four months of the time period covered by the policy) is a prepaid expense. For Northeast Art, all current assets total $182,000.

ANNA PASICHNYK/SHUTTERSTOCK.COM

This Caterpillar bulldozer is no toy. While the child is wondering if he could drive this monster, this bulldozer is a necessary piece of equipment that costs thousands of dollars for a construction company. Like all other assets, the value of this bulldozer and other heavy construction equipment would be listed as a fixed asset on the construction firm's balance sheet.

Fixed Assets **Fixed assets** are assets that will be held or used for a period longer than one year. They generally include land, buildings, and equipment used in the continuing operation of the business. Although Northeast Art owns no land or buildings, it does own delivery equipment that originally cost $110,000. It also owns furniture and store equipment that originally cost $62,000.

Note that the values of both fixed assets are decreased by their *accumulated depreciation*. **Depreciation** is the process of apportioning the cost of a fixed asset over the period during which it will be used. The depreciation amount allotted to each year is an expense for that year, and the value of the asset must be reduced by the amount of depreciation expense. For example, $20,000 of Northeast's delivery equipment value has been depreciated since it was purchased. Its value at this time is $110,000 less $20,000, or $90,000. For Northeast Art, all fixed assets total $137,000.

liquidity the ease with which an asset can be converted into cash

current assets assets that can be converted quickly into cash or that will be used in one year or less

fixed assets assets that will be held or used for a period longer than one year

depreciation the process of apportioning the cost of a fixed asset over the period during which it will be used

Intangible Assets **Intangible assets** are assets that do not exist physically but that have a value based on the rights or privileges they confer on a firm. They include patents, copyrights, trademarks and brands, and goodwill. By their nature, intangible assets are long-term assets—they are of value to the firm for a number of years.

Northeast Art Supply lists a *patent* for a special oil paint that the company purchased from the inventor. The firm's accountants estimate that the patent has a current market value of $21,000. The firm's intangible assets total $21,000. Now it is possible to add the total amounts for current assets ($182,000), fixed assets ($137,000), and intangible assets ($21,000) to calculate total assets for Northeast Art. As shown in Figure 15-6, total assets are $340,000.

15-5d Liabilities and Owners' Equity

The liabilities and the owners' equity accounts complete the balance sheet. The firm's liabilities are separated into two categories—current and long-term liabilities.

Current Liabilities A firm's **current liabilities** are debts that will be repaid in one year or less. Northeast Art Supply purchased merchandise from its suppliers on credit. Thus, its balance sheet includes an entry for accounts payable. *Accounts payable* are short-term obligations that arise as a result of a firm making credit purchases.

Notes payable are obligations that have been secured with promissory notes. They are usually short-term obligations, but they may extend beyond one year. Only those that must be paid within the year are listed under current liabilities.

Northeast Art also lists *salaries payable* and *taxes payable* as current liabilities. These are both expenses that have been incurred during the current accounting period but will be paid in the next accounting period. For Northeast Art, current liabilities total $70,000.

Long-Term Liabilities **Long-term liabilities** are debts that need not be repaid for at least one year. Northeast Art lists only one long-term liability—a $40,000 *mortgage payable* for store equipment. As you can see in Figure 15-6, Northeast Art's current and long-term liabilities total $110,000.

Owners' or Stockholders' Equity For a sole proprietorship or partnership, the owners' equity is shown as the difference between assets and liabilities. In a partnership, each partner's share of the ownership is reported separately in each owner's name. For a corporation, the owners' equity usually is referred to as *stockholders' equity*. The dollar amount reported on the balance sheet is the total value of stock plus retained earnings that have accumulated to date. **Retained earnings** are the portion of a business's profits not distributed to stockholders.

The original investment by the owners of Northeast Art Supply was $150,000 and was obtained by selling 25,000 shares at $6 per share. In addition, $80,000 of Northeast Art's earnings have been reinvested in the business since it was founded. Thus, owners' equity totals $230,000. Now it is possible to add the total for liabilities ($110,000) and owners' equity ($230,000) to calculate the total for liabilities and owners' equity. As shown in Figure 15-6, the sum of total liabilities and owners' equity is $340,000.

As the two grand totals in Figure 15-6 show, Northeast Art's assets and the sum of its liabilities and owners' equity are equal—at $340,000. The accounting equation (Assets = Liabilities + Owners' equity) is still in balance.

intangible assets assets that do not exist physically but that have a value based on the rights or privileges they confer on a firm

current liabilities debts that will be repaid in one year or less

long-term liabilities debts that need not be repaid for at least one year

retained earnings the portion of a business's profits not distributed to stockholders

✓ Concept Check

- How are current assets distinguished from fixed assets?
- Why are fixed assets depreciated on a firm's balance sheet?
- How do you determine the dollar amount of owners' equity for a sole proprietorship, a partnership, or a corporation?
- If a business firm has assets worth $170,000 and liabilities that total $40,000, what is the value of the owners' equity?

Sustaining the Planet

Accountants Grow Concerned About Social and Environmental Issues

To measure the effect a business has on society and the environment, many businesses use social accounting to take a look at the bigger picture. This type of accounting considers how the organization creates value for various stakeholders and attempts to demonstrate how organizations are providing not only economic value, but also how businesses impact society and the environment. Even though many companies issue annual social responsibility audits and sustainability reports along with their financial reports, they are often separate, which makes it difficult to make connections between financial performance and the impact a firm has on society.

According to a survey by the Association of Chartered Certified Accountants (ACCA), accountants are worried about environmental and social issues. In fact, 90 percent of those surveyed believe businesses can make a more positive impact on society and the environment. Ninety-five percent of the accountants surveyed also agreed that accountants and finance managers have a role to play in building a more socially inclusive and environmentally protected world in the future. Already, accountants in many businesses are beginning to track the results and costs of a firm's social impact and sustainability activities. However, experts are quick to point out that an organization's social responsibility and environmental initiatives should not be judged solely on the financial cost.

Conclusion: Even though more and more accountants recognize the need for businesses to better address social inequalities and environmental issues, there are still some barriers that discourage more robust social accounting activities. Potential costs, lack of buy-in from upper management, and misaligned financial priorities can hinder efforts to improve the current situation. Still, it is important to effectively measure an organization's social and environmental impact to prove that these activities provide value. And combining financial data with social and environmental data can strengthen the case for businesses to invest further in these types of initiatives.

Sources: Based on information in Carleton Centre for Community Innovation, "Accounting for Social Impact," March 10, 2021, https://carleton.ca/3ci/wp-content/uploads/Expanded-Value-Added.pdf; Michael Cohn, "Accountants Worried About Environmental and Social Issues," *Accounting Today*, October 13, 2020, www.accountingtoday.com/news/accountants-worried-about-environmental-and-social-issues; George Spencer, "5 Steps for Reliable ESG Reporting Amid Growing Demand," *Journal of Accountancy*, February 5, 2021, www.journalofaccountancy.com/news/2021/feb/reliable-esg-reporting-amid-growing-demand.html.

15-6 The Income Statement

Learning Objective

15-6 Interpret an income statement.

Question: *Where can you find the profit amount for Apple, Inc.?*

Answer: The firm's income statement.

An **income statement** is a summary of a firm's revenues and expenses during a specified accounting period—one month, three months, six months, or a year. The income statement is sometimes called the *earnings statement* or *the statement of income and expenses*. Let's begin our discussion by constructing a personal income statement for Marty Campbell. Having worked as a sales representative for a medical supply firm for the past three years, Marty now earns $45,000 a year, or $3,750 a month. After deductions, his take-home pay is $2,625 a month. As illustrated in Figure 15-7, Marty's typical monthly expenses include payments for an automobile loan, credit card payments, apartment rent, utilities, food, clothing, and recreation and entertainment.

income statement a summary of a firm's revenues and expenses during a specified accounting period

Although the difference between income and expenses is referred to as *profit* or *loss* for a business, it is normally referred to as a *cash surplus* or *cash deficit* for

Figure 15-7 Personal Income Statement

By subtracting expenses from income, you can construct a personal income statement and determine if you have a surplus or deficit at the end of each month.

Marty Campbell
Personal Income Statement
For the month ended December 31, 20XX

INCOME (Take-home pay)		$2,625
LESS MONTHLY EXPENSES		
Automobile loan	$ 350	
Credit card payment	100	
Apartment rent	900	
Utilities	200	
Food	325	
Clothing	100	
Recreation & entertainment	250	
TOTAL MONTHLY EXPENSES		2,225
CASH SURPLUS (or profit)		$ 400

an individual. Fortunately for Marty, he has a surplus of $400 at the end of each month. He can use this surplus for savings, investing, or paying off debts. It is also possible to use the information from a personal income statement to construct a personal budget. A *personal budget* is a specific plan for spending your income—over the next month or a specified time period.

Figure 15-8 shows the income statement for Northeast Art Supply. For a business,

Revenues *less* → Cost of goods sold *less* → Operating expenses equals → Net income

15-6a Revenues

Revenues are the dollar amounts earned by a firm from selling goods, providing services, or performing business activities. Like most businesses, Northeast Art Supply obtains its revenues solely from the sale of its products or services. The revenues section of its income statement begins with gross sales. **Gross sales** are the total dollar amount of all goods and services sold during the accounting period. Deductions made from this amount are:

- *sales returns*—merchandise returned to the firm by its customers;
- *sales allowances*—price reductions offered to customers who accept slightly damaged or soiled merchandise; and
- *sales discounts*—price reductions offered to customers who pay their bills promptly.

The remainder is the firm's net sales. **Net sales** are the actual dollar amounts received by the firm for the goods and services it has sold after adjustment for returns, allowances, and discounts. For Northeast Art, net sales are $451,000.

revenues the dollar amounts earned by a firm from selling goods, providing services, or performing business activities

gross sales the total dollar amount of all goods and services sold during the accounting period

net sales the actual dollar amounts received by a firm for the goods and services it has sold after adjustment for returns, allowances, and discounts

Figure 15-8 Business Income Statement

An income statement summarizes a firm's revenues and expenses during a specified accounting period. For Northeast Art Supply, net income after taxes is $28,045.

NORTHEAST ART SUPPLY, INC.

Income Statement
for the Year Ended
December 31, 20XX

Revenues			
Gross sales		$465,000	
Less sales returns and allowances	$ 9,500		
Less sales discounts	4,500	14,000	
Net sales			$451,000
Cost of goods sold			
Beginning inventory, January 1, 20XX		$ 40,000	
Purchases	$346,000		
Less purchase discounts	11,000		
Net purchases		335,000	
Cost of goods available for sale		$375,000	
Less ending inventory December 31, 20XX		41,000	
Cost of goods sold			334,000
Gross profit			$117,000
Operating expenses			
Selling expenses			
Sales salaries	$ 22,000		
Advertising	4,000		
Sales promotion	2,500		
Depreciation—store equipment	3,000		
Depreciation—delivery equipment	4,000		
Miscellaneous selling expenses	1,500		
Total selling expenses		$ 37,000	
General expenses			
Office salaries	$ 28,500		
Rent	8,500		
Depreciation—furniture	1,500		
Utilities expense	2,500		
Insurance expense	1,000		
Miscellaneous expense	500		
Total general expense		42,500	
Total operating expenses			79,500
Net income from operations			$ 37,500
Less interest expense			2,000
NET INCOME BEFORE TAXES			$ 35,500
Less federal income taxes			7,455
NET INCOME AFTER TAXES			$ 28,045

15-6b **Cost of Goods Sold**

The standard method of determining the **cost of goods sold** by a retailing or a wholesaling firm can be summarized as follows:

Cost of goods sold = Beginning inventory + Net purchases – Ending inventory

According to Figure 15-8, Northeast Art Supply began its accounting period on January 1 with a merchandise inventory that cost $40,000. During the next 12 months, the firm purchased merchandise valued at $346,000. After deducting *purchase discounts*, however, it paid only $335,000 for this merchandise. Thus, during the year, Northeast had total *goods available for sale* valued at beginning inventory ($40,000) plus net purchases ($335,000), for a total of cost of goods available for sale ($375,000).

Twelve months later, at the end of the accounting period on December 31, Northeast still had inventory valued at $41,000. For Northeast, the cost of goods available for sale ($375,000) less ending inventory ($41,000) equals the firm's total of cost of goods sold ($334,000). It is now possible to calculate gross profit.

cost of goods sold the dollar amount equal to beginning inventory *plus* net purchases *less* ending inventory

Income Statement
REVENUE
Sale revenue
Sales
Cost of goods sold
451,829

CASPER1774 STUDIO/SHUTTERSTOCK.COM

If you want to know if a company is profitable or not, look at its income statement. An income statement is the "go-to" source for executives, managers, employees, and investors who want to know if a firm is earning a profit or operating at a loss. This same statement also contains information about its costs of goods sold, operating expenses, finance costs, and the amount of taxes it must pay.

The firm's **gross profit** is net sales ($451,000) *less* cost of goods sold ($334,000), for a $117,000 gross profit.

15-6c **Operating Expenses**

A firm's **operating expenses** are all business costs other than the cost of goods sold. Total operating expenses generally are divided into two categories: selling expenses and general expenses.

Selling expenses are costs related to the firm's marketing activities. For Northeast Art Supply, selling expenses total $37,000. *General expenses* are costs incurred in operating a business, in this case, a total of $42,500. Now it is possible to total both selling and general expenses. As Figure 15-8 shows, total operating expenses for the accounting period are $79,500.

15-6d **Net Income**

When revenues exceed expenses, the difference is called **net income**. When expenses exceed revenues, the difference is called **net loss**.

Profit or Loss = Revenues − Expenses

As Figure 15-8 shows, Northeast Art's *net income from operations* is computed as gross profit ($117,000) less total operating expenses ($79,500). For Northeast Art, net income from operations is $37,500. From this amount, *interest expense* of $2,000 is deducted to obtain a *net income before taxes* of $35,500. The interest expense is deducted in this section of the income statement because it is not an operating expense. Rather, it is an expense that results from financing the business.

Northeast Art's *federal income taxes* are $7,455. Although these taxes may or may not be payable immediately, they are definitely an expense that must be deducted from income. This leaves Northeast Art with a *net income after taxes* of $28,045. This amount may be used to pay a dividend to stockholders, it may be retained or reinvested in the firm, it may be used to reduce the firm's debts, or all three.

✓ Concept Check

- What is the difference between a balance sheet and an income statement?
- Explain how a retailing firm would determine the cost of goods sold during an accounting period.
- If a retailer has revenues of $700,000, cost of goods sold that total $270,000, and operating expenses that total $200,000, what is its net income before taxes?

Learning Objective

15-7 Describe business activities that affect a firm's cash flow.

15-7 The Statement of Cash Flows

Cash is vital to any business. Both the Securities and Exchange Commission and the Financial Accounting Standards Board require all publicly traded companies to include a statement of cash flows, along with their balance sheet and income statement, in their annual report. The **statement of cash flows** illustrates how the company's operating, investing, and financing activities affect cash during an accounting period. While a firm's balance sheet reports dollar values for assets, liabilities, and owners' equity and an income statement reports the firm's dollar amount of profit or loss, the statement of cash flows focuses on how much cash is on hand to pay the firm's bills. Also, the information on the statement of cash flows can be used to evaluate decisions related to a firm's future investments and financing needs. Investors, lenders, and suppliers are also interested in a firm's statement of cash flows. Investors want to know if a firm can pay dividends. Before extending credit to a firm, lenders and suppliers often use the information on the statement of cash flows to evaluate the firm's ability to repay its debts.

gross profit a firm's net sales *less* the cost of goods sold

operating expenses all business costs other than the cost of goods sold

net income occurs when revenues exceed expenses

net loss occurs when expenses exceed revenues

A statement of cash flows for Northeast Art Supply is illustrated in Figure 15-9. It provides information concerning the company's cash receipts and cash payments and is organized around three different activities: operating, investing, and financing.

- *Cash flows from operating activities*. This is the first section of a statement of cash flows. It addresses the firm's primary revenue source—providing goods and services. Typical adjustments include adding the amount of depreciation to a firm's net income. Other adjustments that increase or decrease the amounts for accounts receivable, inventory, accounts payable, and income taxes payable are also required to reflect a true picture of cash flows from operating activities.
- *Cash flows from investing activities*. The second section of the statement is concerned with cash flow from investments. This includes the purchase and sale of equipment, land, and other assets and investments.
- *Cash flows from financing activities*. The third and final section deals with the cash flow from all financing activities. It reports changes in debt obligation and owners' equity accounts. This includes loans and repayments, the sale and repurchase of the company's own stock, and cash dividends.

The totals of all three activities are added to the beginning cash balance to determine the ending cash balance. For Northeast Art Supply, the ending cash

statement of cash flows a statement that illustrates how the company's operating, investing, and financing activities affect cash during an accounting period

Figure 15-9 Statement of Cash Flows

A statement of cash flows summarizes how a firm's operating, investing, and financing activities affect its cash during a specified accounting period. For Northeast Art Supply, the amount of cash at the end of the year reported on the statement of cash flows is $59,000—the same amount reported for the cash account on the firm's balance sheet.

NORTHEAST ART SUPPLY, INC.

Statement of Cash Flows
for the Year Ended
December 31, 20XX

Cash flows from operating activities		
Net Income		$28,045
Adjustments to reconcile net income to net cash flows		
Depreciation	$ 8,500	
Decrease in accounts receivable	1,000	
Increase in inventory	(5,000)	
Increase in accounts payable	6,000	
Increase in income taxes payable	3,000	13,500
Net cash provided by operating activities		$41,545
Cash flows from investing activities		
Purchase of equipment	$ (2,000)	
Purchase of investments	(10,000)	
Sale of investments	20,000	
Net cash provided by investing activities		8,000
Cash flows from financing activities		
Payments on debt	$(23,000)	
Payment of dividends	(5,000)	
Net cash provided by financing activities		(28,000)
NET INCREASE IN CASH		$21,545
Cash at beginning of year		37,455
CASH AT END OF YEAR		$59,000

✓ Concept Check

- What is the purpose of the statement of cash flows?
- In a statement of cash flows, what is included in the operating activities section? In the investing activities section? In the financial activities section?

balance is $59,000. Note that this is the same amount reported for the cash account on the firm's balance sheet. Together, the statement of cash flows, balance sheet, and income statement illustrate the results of past business decisions and reflect the firm's ability to pay debts and dividends and to finance new growth.

15-8 Evaluating Financial Statements

Learning Objective

15-8 Summarize how managers evaluate the financial health of a business.

All three financial statements—the balance sheet, the income statement, and the statement of cash flows—can provide answers to a variety of questions about a firm's ability to do business and stay in business, its profitability, and its value as an investment. Even more information about a firm's financial health can be obtained by comparing its financial information with the same information for competing firms, with industry averages, and with its financial information over recent accounting periods.

15-8a Comparing Financial Data

Comparisons of a firm's financial and accounting information are possible as long as accountants follow GAAPs to prepare the firm's financial statements. Except for minor differences in format and terms, a balance sheet, income statement, and statement of cash flows for Lowe's, for example, will be similar to the financial statements for Home Depot because both companies are in the home improvement industry. Comparisons among firms give executives, managers, and employees a general idea of a firm's standing within the industry. Competitors' financial information can be obtained from their annual reports, information filed with the SEC, and investment sites like Bloomberg and Yahoo! Finance—if they are public corporations. Industry averages are published by reporting services such as Dun & Bradstreet (D&B) and BizMiner, as well as by some industry trade associations.

Today, most corporations include in their annual reports comparisons of the important elements of their financial statements for recent years. For example, Figure 15-10 shows comparisons—of revenue, research and development (R&D) costs, operating income, and sales and marketing expenses—for Microsoft Corporation, a world leader in the computer software industry. By examining this information, a manager in the research and development division can tell whether R&D expenditures have been increasing or decreasing over the past three years. The vice president of marketing can determine if the total amount of sales and marketing expenses is changing. Stockholders and potential investors, on the other hand, may be more concerned with increases or decreases in Microsoft's revenues and operating income over the same time period. Still another type of analysis of a firm's financial health involves computation of financial ratios.

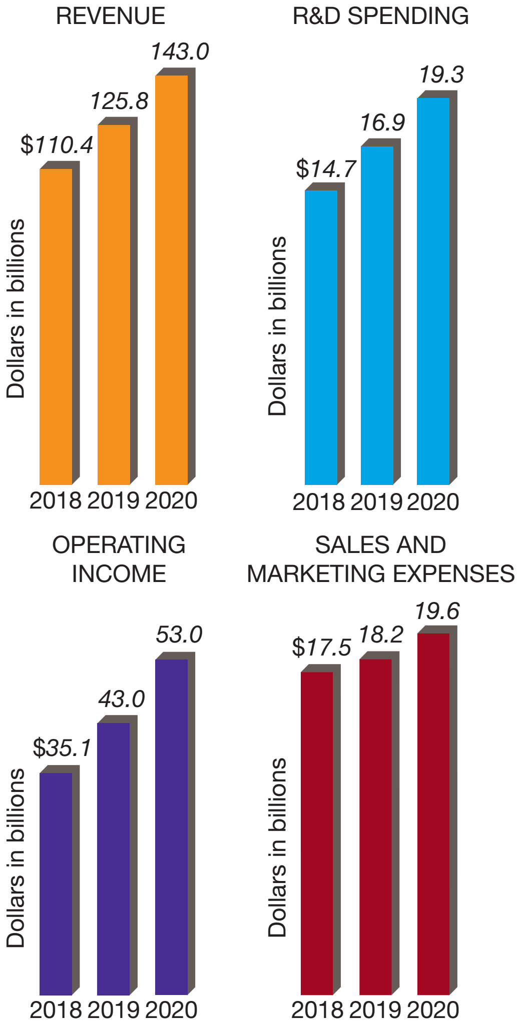
15-8b Financial Ratios

A **financial ratio** is a number that shows the relationship between two elements of a firm's financial statements. While it is possible to calculate many different financial ratios, we'll only discuss three different ratios that are used to measure a firm's profitability, its ability to pay its debts, and how often it sells its inventory. Like the individual elements in financial statements, these ratios can be compared with those of competitors, with industry averages, and with the firm's past ratios from previous accounting periods. The information required

financial ratio a number that shows the relationship between two elements of a firm's financial statements

Figure 15-10 **Comparisons of Present and Past Financial Statements for Microsoft Corporation**

Most corporations include in their annual reports comparisons of the important elements of their financial statements for recent years.



Source: Adapted from the Microsoft Corporation 2020 Annual Report, www.microsoft.com (accessed February 23, 2021).

to form these ratios is found in a firm's balance sheet, income statement, and statement of cash flows.

Measuring a Firm's Ability to Earn Profits A firm's net income after taxes indicates whether the firm is profitable. It does not, however, indicate how effectively the firm's resources are being used. For this latter purpose, a net profit margin can be computed. **Net profit margin** (sometimes called **return on sales**) is a financial ratio calculated by dividing net income after taxes by net sales. For Starbucks—a company known for world class coffee—its net profit margin is 4.8 as calculated below.

$$\text{Net profit margin} = \frac{\text{Net income after taxes}}{\text{Net sales}} = \frac{\$\ 928 \text{ million}}{\$\ 19{,}165 \text{ million}}$$

$$= 0.048 = 4.8 \text{ percent}$$

net profit margin (or **return on sales**) a financial ratio calculated by dividing net income after taxes by net sales

A higher return on sales is better than a low one. Today, the average net profit margin for all business firms is between 4 and 5 percent. With a return on sales of 4.8 percent, Starbucks is toward the high end of the average. A low return on sales can be increased by reducing expenses and increasing sales.

Measuring a Firm's Ability to Pay Its Debts A current ratio can be used to evaluate a firm's ability to pay its current liabilities. A firm's **current ratio** is computed by dividing current assets by current liabilities. The current ratio for Starbucks is 1.06 as calculated below.

$$\textbf{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} = \frac{\$7{,}806 \text{ million}}{\$7{,}347 \text{ million}} = 1.06$$

This ratio indicates that Starbucks has $1.06 of current assets for every $1 of current liabilities. The average for this ratio varies greatly from industry to industry, but many financial experts suggest that a firm's current ratio should range between 1.2 and 2 depending on the industry. A high current ratio indicates that a firm can pay its current liabilities. A low current ratio (below 1.2) can be improved by repaying current liabilities, reducing expenses, reducing dividend payments to stockholders to increase the firm's cash balance, or obtaining additional cash from investors.

Measuring How Well a Firm Manages Its Inventory A firm's **inventory turnover** is the number of times the firm sells its merchandise inventory in one year. It is approximated by dividing the cost of goods sold in one year by the average value of the inventory.

The average value of the inventory for one accounting period can be found by adding the beginning inventory value and the ending inventory value and dividing the sum by 2. The inventory turnover for Starbucks is 5 as calculated below.

current ratio a financial ratio computed by dividing current assets by current liabilities

inventory turnover a financial ratio calculated by dividing the cost of goods sold in one year by the average value of the inventory

$$\textbf{Inventory turnover} = \frac{\text{Cost of goods sold}}{\text{Average inventory}} = \frac{\$7{,}695 \text{ million}}{\$1{,}540 \text{ million}} = 5$$

Starbucks sells its merchandise inventory five times each year, or about once every 73 days. The average inventory turnover for all firms ranges between 5 and 10 depending on the industry. For example, supermarkets may have inventory turnover rates of 20 or higher, whereas inventory turnover rates for furniture stores are generally well below the national average. The quickest way to improve inventory turnover is to order merchandise in smaller quantities at more frequent intervals.

Like the three ratios described in this section, the calculations for other financial ratios, including return on owners' equity, earnings per share, working capital, and debt-to-equity, are based on the information contained in a firm's balance sheet, income statement, and statement of cash flows. For more detailed information on ratio analysis, you may want to read more on the topic in an accounting or finance textbook or use an internet search engine.

In this chapter we have discussed the importance of information and accounting information. In Chapter 16, we examine how information can help improve a firm's financial planning. We also examine why firms need financing, how they obtain it, and how they ensure that funds are used effectively in keeping with the organization's goals.

✓ Concept Check

- What are the benefits of comparing a firm's current financial information with information for previous accounting periods, with industry averages, and with financial information for competitors?
- Explain the calculation procedures for and significance of each of the following:
  a. Net profit margin
  b. Current ratio
  c. Inventory turnover

Summary

15-1 Examine how information can reduce risk when making a decision.

Information produces knowledge and empowers managers and employees to make better decisions. Because of the volume of information they receive each day and their need to make decisions on a daily basis, businesspeople use information rules to shorten the time spent analyzing choices. Although many people use the terms *data* and *information* interchangeably, there is a difference. Data are numerical or verbal descriptions that usually result from some sort of measurement. Information is data presented in a form that is useful for a specific purpose. A database is a single collection of data and information stored in one place that can be used by people throughout an organization to make decisions. Management information experts now use the term knowledge management (KM) to describe a firm's procedures for generating, using, and sharing data and information. To aid the decision-making process, managers and employees can use a decision-support system (DSS), expert system, and business application software to make decisions and to report data and information.

15-2 Discuss management's information requirements.

A management information system (MIS) is a means of providing managers with the information they need to perform their jobs as effectively as possible. The purpose of an MIS (sometimes referred to as an information technology system or simply an IT system) is to distribute timely and useful information to the decision makers who need it. The specific types of information managers need depend on their area of management and level within the firm. The size and complexity of an MIS must be tailored to the information needs of the organization it serves.

15-3 Outline the five functions of an information system.

The five functions performed by an MIS system are collecting data, storing data, updating data, processing data into information, and presenting information. Data may be collected from internal sources and external sources. An MIS must be able to store data until they are needed and to update them regularly to ensure that the information presented to managers and employees is accurate, complete, and timely. Data processing is the MIS function that transforms stored data into a form useful for a specific purpose. Finally, the processed data (which now can be called information) must be presented in a form that is useful. Verbal information generally is presented in the form of a report. Numerical information is often displayed in graphs, charts, or tables.

15-4 Explain why accurate accounting information and audited financial statements are important.

Accounting is the process of systematically collecting, analyzing, and reporting financial information. It can be used to answer questions about what has happened in the past; it also can be used to help make decisions about the future. The purpose of an audit is to make sure that a firm's financial statements and accounting information have been prepared in accordance with generally accepted accounting principles (GAAPs). To help ensure that corporate financial information is accurate and in response to accounting scandals, the Sarbanes-Oxley Act was signed into law. Although many people think all accountants do the same thing, typical areas of expertise include managerial, financial, cost, tax, government, and not-for-profit. A private accountant is employed by a private firm. A public accountant performs accounting work for various individuals or firms on a fee basis. Most accounting firms include on their staffs at least one CPA.

15-5 Interpret a balance sheet.

A balance sheet (sometimes referred to as a statement of financial position) is a summary of a firm's assets, liabilities, and owners' equity accounts at the end of an accounting period. This statement must demonstrate that the accounting equation is in balance. On the balance sheet, assets are categorized as current, fixed, or intangible. Liabilities can also be classified as current liabilities and long-term liabilities. For a sole proprietorship or partnership, owners' equity is shown as the difference between assets and liabilities. For corporations, the owners' equity is the total value of stock when issued plus retained earnings that have accumulated to date.

15-6 Interpret an income statement.

An income statement is a summary of a firm's revenues and expenses during the specified accounting period. On the income statement, the company's gross profit is computed by subtracting the cost of goods sold from net sales. Operating expenses and interest expenses then are deducted to compute net income before taxes. Finally, income taxes are deducted to obtain the firm's net income after taxes.

15-7 Describe business activities that affect a firm's cash flow.

Both the Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) require all publicly traded companies to include a statement of cash flows in their annual reports. This statement illustrates how the company's operating, investing, and financing activities affect cash during an accounting period. The information in this statement helps employees, investors, and other interested people to evaluate the financial health of a business.

15-8 Summarize how managers evaluate the financial health of a business.

The firm's financial statements and its accounting information become more meaningful when compared with the company's corresponding information for competitors, for the industry in which the firm operates, and the firm's own information from previous accounting periods. Such comparisons permit managers, employees, lenders, investors, and other interested people to pick out trends in growth, borrowing, income, and other business variables and to determine whether the firm is on the way to accomplishing its long-term goals. A number of financial ratios can be computed from the information in a firm's financial statements. These ratios provide a picture of a firm's profitability, its ability to pay its debts, and how often it sells its inventory. Like the information on the firm's financial statements, these ratios can and should be compared with corresponding information for previous years, for competitors, and for the industry in which the firm operates.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

data (436)
information (436)
database (437)
knowledge management (KM) (437)
decision-support system (DSS) (437)
expert system (438)
management information system (MIS) (438)
data processing (442)
statistic (442)
accounting (444)
audit (444)
generally accepted accounting principles (GAAPs) (444)
managerial accounting (446)
financial accounting (447)
certified public accountant (CPA) (448)
assets (449)
liabilities (449)
owners' equity (449)
accounting equation (449)
double-entry bookkeeping system (449)
annual report (449)
balance sheet (or statement of financial position) (449)
liquidity (451)
current assets (451)
fixed assets (451)
depreciation (451)
intangible assets (452)
current liabilities (452)
long-term liabilities (452)
retained earnings (452)
income statement (453)
revenues (454)
gross sales (454)
net sales (454)
cost of goods sold (455)
gross profit (456)
operating expenses (456)
net income (456)
net loss (456)
statement of cash flows (456)
financial ratio (458)
net profit margin (or return on sales) (459)
current ratio (460)
inventory turnover (460)

Discussion Questions

1. Do managers really need all the kinds of information discussed in this chapter? If not, which kinds can they do without?
2. How can confidential data and information (such as the wages of individual employees) be kept confidential and yet still be available to managers who need them?
3. Bankers usually insist that prospective business borrowers submit audited financial statements along with a loan application. Why should financial statements be audited by a CPA?
4. Do the balance sheet, income statement, and statement of cash flows contain all the information you might want as a potential lender or investor? What other information would you like to examine?
5. Of the three financial ratios discussed in this chapter, which do you think is the most important financial ratio? Why?

Case 15

How Larry Ellison and Oracle Plan to Win the Cloud Wars

Larry Ellison is an American businessperson and is one of the wealthiest people in the world. He is chairperson, chief technology officer, and co-founder of Oracle, an integrated cloud applications and platform services company based in Austin, Texas. The company sells cloud-based tools to store and analyze data and information as well as software, hardware, and other technology applications. The company was founded in 1977 after Ellison discovered there was a growing need for database management systems. Just two years later, the company introduced its own database management system, finally answering the question of how technology could help companies manage large amounts of data and information.

Oracle has always had a reputation for introducing new products before competitors. It developed the first client-server database, the first media server to support video on demand, and the first internet development suite, among others. The company's goal has always been to help its business customers collect, store, update, process, and present data—the five management information system functions described in this chapter. Now, according to Ellison, Oracle's databases manage most of the world's data with more than 430,000 customers in 175 countries. "We are the dominant database supplier on the planet Earth," Ellison said on a recent earning's call. He went on to say, "we're bigger than IBM and Microsoft combined" when it comes to total database revenues.

Oracle competes with companies such as technology giants IBM, Microsoft, and Amazon Web Service (AWS), which offer similar cloud databases and other cloud-based services. Though Oracle admittedly took longer than its competitors to take its database to the cloud, Ellison believes its systems are now more secure and more affordable than other available systems. In fact, Ellison plans to win the cloud wars by competing on price, quality, and security.

Lower pricing for Oracle's products that are recognized for quality helps Oracle win new customers. According to Oracle, its cloud infrastructure, for example, is consistently less expensive than Amazon Web Services. The method used to price some products also helps Oracle win new customers. Customers who use Oracle's FastConnect infrastructure, which transfers information from customer data centers to the cloud through private connections, pay fixed monthly charges. The fixed charge means that their customers have a predictable monthly bill compared to AWS customers who are billed based on data transfer activity.

To keep a leg up on the competition, Oracle invests heavily in research and development (R&D), which generates world-class technologies. The company has spent $56 billion on R&D since 2012 and an additional $80 billion on acquisitions of companies that had promising ideas or products that fit with Oracle's product mix. Its R&D activities are constantly finding ways to introduce new or improve existing products that can satisfy customer needs. For instance, Oracle created the world's first autonomous database. The product, Oracle Autonomous Linux, serves to reduce maintenance and downtime and at the same time increase security. Before Oracle's new product was introduced, companies that attempted to take their large workloads to the cloud experienced high costs and security concerns. When Oracle Autonomous Linux was introduced, the company had thousands of customers waiting in the wings for the product to be deployed in addition to thousands more who signed up for product demonstrations.

The company has also made significant investments in security all the way down to the chip level to reduce concerns of advanced and persistent threats that use sophisticated hacking techniques to steal data. Its products have layered security defenses and controls such as security zones, data encryption, and firewalls. This security-first approach builds trust among Oracle customers. One of the major selling points of its autonomous database is that it eliminates human error while improving cybersecurity.

A culture of innovation has fueled Oracle since day one. Ellison is competitive by nature and will do what it takes to build the best cloud management system and technology products possible. Introducing new and innovative products that are recognized for their quality, pricing its products competitively, and taking a security-first approach make Oracle a leader in cloud computing.[6]

Discussion Questions

1. While Oracle is a recognized giant in the technology world, it competes with other successful companies including IBM, Microsoft, and Amazon Web Services. Describe the three factors that Larry Ellison plans to use to win the technology wars.
2. Although Oracle is successful, it continues to invest in research and development and acquire other companies that have promising ideas or products that complement Oracle's product mix. Explain why you think continued research and development and acquisitions are important for Oracle's future growth.
3. How important is protection from hackers and computer security for a technology company like Oracle? What steps is Oracle taking to protect information stored in its cloud-based database and technology products?

Building Skills for Career Success

1. Social Media Exercise

All of the Big Four accounting firms are active on Twitter, as well as posting messages, content, and photos on Facebook, listing job openings on LinkedIn, and posting videos on YouTube. The idea is to connect with potential job candidates, interact with clients and potential clients, engage employees, showcase the firm's expertise, and polish their reputations.

Assignment

1. Choose one of the Big Four accounting firms (Deloitte, PricewaterhouseCoopers, Ernst & Young, or KPMG) and take a look at the information it posts on Twitter, Facebook, LinkedIn, or YouTube.
2. How does the accounting firm you chose use social media? Are they trying to reach potential job candidates, existing clients and potential clients, or employees?
3. Do you think that social media is an effective way for an accounting firm to reach its target audience?

2. Building Team Skills

This has been a bad year for Park Avenue Furniture. The firm increased sales revenues to $1,400,000, but total expenses ballooned to $1,750,000. Although management realized that some of the firm's expenses were out of control, including cost of goods sold ($700,000), salaries ($450,000), and advertising costs ($140,000), it could not contain expenses. As a result, the furniture retailer lost $350,000. To make matters worse, the retailer applied for a $350,000 loan at Fidelity International Bank and was turned down. The bank officer, Mike Nettles, said the firm had a net loss for the last 12 months and that the firm already had too much debt. At that time, liabilities totaled $420,000 and owners' equity was $600,000.

Assignment

1. In groups of three or four, analyze the financial condition of Park Avenue Furniture.
2. Discuss why you think the bank officer turned down Park Avenue's loan request.
3. Prepare a detailed plan of action to improve the financial health of Park Avenue Furniture over the next 12 months.

3. Researching Different Careers

To improve productivity, employers expect employees to use computers and computer software. Typical business applications include email, word processing, accounting, graphics, spreadsheets, and other business application software programs. By improving your skills in these areas, you can increase your chances not only of being employed but also of being promoted once you are employed.

Assignment

1. Assess your computer skills by placing a check in the appropriate column in the following table:

	Skill Level			
Software	**None**	**Low**	**Average**	**High**
Email				
Word processing				
Desktop publishing				
Accounting				
Database management				
Graphics				
Spreadsheet				
Internet research				

2. Describe your self-assessment in a written report. Specify the skills in which you need to become more proficient, and outline a plan for improvement.

Chapter

16

PRESSMASTER/SHUTTERSTOCK.COM

Mastering Financial Management

Learning Objectives

Once you complete this chapter, you will be able to:

16-1 Explain why financial management is important in today's competitive economy.

16-2 Identify a firm's short- and long-term financial needs.

16-3 Summarize the process of planning for financial management.

16-4 Identify the services provided by banks and financial institutions for their business customers.

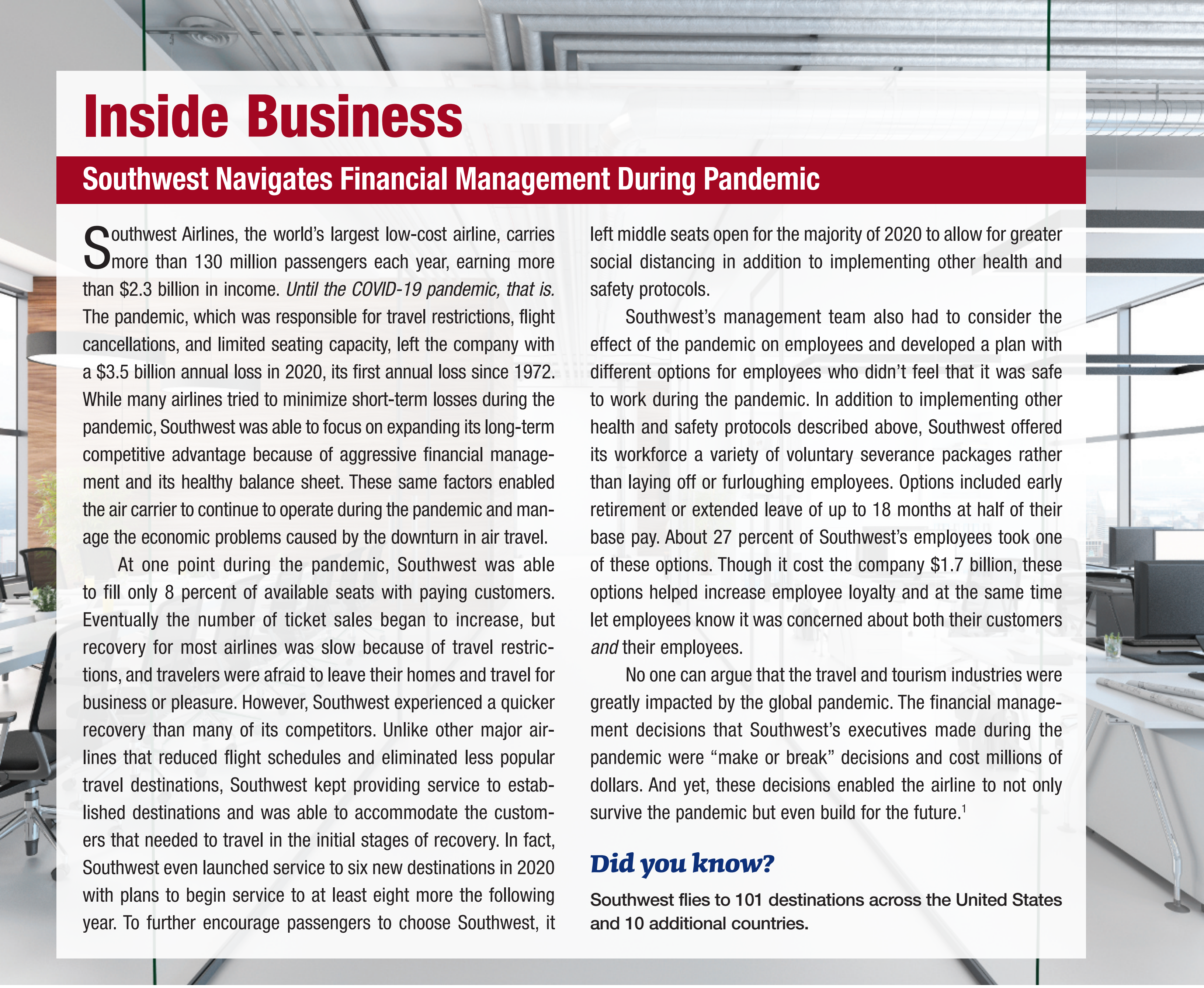
16-5 Describe the advantages and disadvantages of different methods of short-term debt financing.

16-6 Evaluate the advantages and disadvantages of equity financing.

16-7 Evaluate the advantages and disadvantages of long-term debt financing.

Why Should You Care?

The old saying goes, "Money makes the world go around." For business firms, this is true. It's hard to operate a business without money. In this chapter, we discuss how financial management is used to obtain money and ensure that it is used effectively.



Inside Business

Southwest Navigates Financial Management During Pandemic

Southwest Airlines, the world's largest low-cost airline, carries more than 130 million passengers each year, earning more than $2.3 billion in income. *Until the COVID-19 pandemic, that is.* The pandemic, which was responsible for travel restrictions, flight cancellations, and limited seating capacity, left the company with a $3.5 billion annual loss in 2020, its first annual loss since 1972. While many airlines tried to minimize short-term losses during the pandemic, Southwest was able to focus on expanding its long-term competitive advantage because of aggressive financial management and its healthy balance sheet. These same factors enabled the air carrier to continue to operate during the pandemic and manage the economic problems caused by the downturn in air travel.

At one point during the pandemic, Southwest was able to fill only 8 percent of available seats with paying customers. Eventually the number of ticket sales began to increase, but recovery for most airlines was slow because of travel restrictions, and travelers were afraid to leave their homes and travel for business or pleasure. However, Southwest experienced a quicker recovery than many of its competitors. Unlike other major airlines that reduced flight schedules and eliminated less popular travel destinations, Southwest kept providing service to established destinations and was able to accommodate the customers that needed to travel in the initial stages of recovery. In fact, Southwest even launched service to six new destinations in 2020 with plans to begin service to at least eight more the following year. To further encourage passengers to choose Southwest, it left middle seats open for the majority of 2020 to allow for greater social distancing in addition to implementing other health and safety protocols.

Southwest's management team also had to consider the effect of the pandemic on employees and developed a plan with different options for employees who didn't feel that it was safe to work during the pandemic. In addition to implementing other health and safety protocols described above, Southwest offered its workforce a variety of voluntary severance packages rather than laying off or furloughing employees. Options included early retirement or extended leave of up to 18 months at half of their base pay. About 27 percent of Southwest's employees took one of these options. Though it cost the company $1.7 billion, these options helped increase employee loyalty and at the same time let employees know it was concerned about both their customers *and* their employees.

No one can argue that the travel and tourism industries were greatly impacted by the global pandemic. The financial management decisions that Southwest's executives made during the pandemic were "make or break" decisions and cost millions of dollars. And yet, these decisions enabled the airline to not only survive the pandemic but even build for the future.[1]

Did you know?

Southwest flies to 101 destinations across the United States and 10 additional countries.

A company like Southwest Airlines can't survive without money! Even though Southwest lost $3.5 billion during the COVID-19 pandemic, its financial management team was able to guide the company to recovery. Financial managers were also able to fund expansion and provide service to new destinations because Southwest had built a strong balance sheet and substantial cash reserves just in case of a downturn in air travel for any reason, including a pandemic.

Without money, employees don't get paychecks, creditors and lenders can't be paid, and the business may close its doors and cease to exist. On the other hand, when a company—like Southwest Airlines, Facebook, Citibank, or a small neighborhood business—manages its finances it can not only pay its bills and employees, but can also meet the needs of its customers and society and even grow and expand.

In this chapter we examine why financial management is important. Then, we discuss how firms find the financing required to start a business and keep it going and then how they manage that money effectively. We also look at how firms develop financial plans and evaluate financial performance. Finally, we examine typical banking services and compare various methods of obtaining short- and long-term financing.

16-1 Why Financial Management?

Learning Objective

16-1 Explain why financial management is important in today's competitive economy.

Many businesses realized how planning coupled with effective financial management could increase their ability to meet the needs of customers, increase sales, and keep the doors open during the COVID-19 pandemic. For example, financial managers for each of the firms listed below had to compare the cost of each action with the potential increase in sales revenue before making a recommendation to implement the following changes:

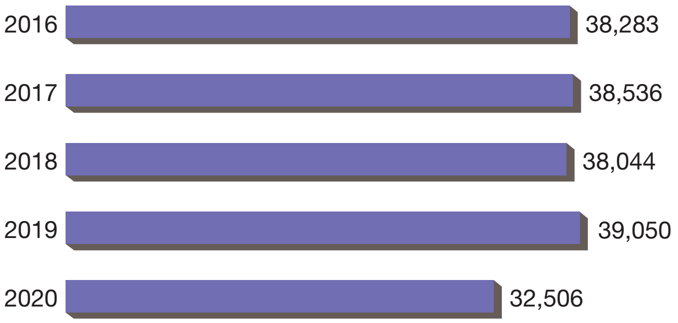
- Red Roof Hotels offered special rates for rooms to provide a quiet, private space for workers who couldn't work at the office or home.
- Best Buy increased its focus on virtual support, technology repair, and promoted its e-commerce site as a way for customers to purchase computers and electronic gear without leaving their home.
- Kroger turned some locations into fulfillment centers designed to speed delivery of merchandise to an increasing number of customers who ordered online.
- Walgreens began offering delivery of personal care products and food items to customers.[2]

While the goals of each of these companies were to meet the needs of customers and increase sales, each action required executives and managers to make important financial decisions to turn the ideas into a reality.

Managers and employees must find the money needed to keep a business operating and fund all the goals and objectives that a successful business wants to achieve. A business that cannot pay its bills may have to close its doors and even be forced to file for bankruptcy protection. As shown in Figure 16-1, the number of business firms filing for bankruptcy varies from one year to the next. However, financial experts agree that the number of business bankruptcies increases or decreases depending on the stage of the business cycle the nation's economy may be in at a specific time. Remember in Chapter 1, a nation's business cycle was compared to a roller coaster ride with periods of prosperity or high points and troughs or low points. A pandemic, political unrest, world economic problems, terrorist threats and wars, interest rates, and other factors can also

Figure 16-1 Business Bankruptcies in the United States

The nation's economy and other factors can affect the number of businesses that file for bankruptcy. (Note: At the time of publication, 2020 was the most recent year for which complete statistics were available.)



Source: Based on the American Bankruptcy Institute website at www.abiworld.org (accessed March 1, 2021).

lead to an increase in business bankruptcies. Despite the COVID-19 pandemic, the number of businesses filing for bankruptcy in 2020 actually decreased when compared to the number of bankruptcy cases for the previous four years.

BANKRUPTCY

CGSTOCK/SHUTTERSTOCK.COM

Poor financial management can lead to bankruptcy. While business owners don't plan to fail, sometimes poor financial management, low sales revenues, poor location, uncontrolled expenses, and a lot of other factors including the nation's economy can cause a business to fail. In thousands of cases each year, bankruptcy may be the only solution for a business that cannot pay its creditors.

16-1a The Need for Financial Management

Financial management consists of all the activities concerned with obtaining money and using it effectively. To some extent, financial management can be viewed as a two-sided problem. On one side, the uses of funds often dictate the type or types of financing needed by a business. On the other side, the activities a business can undertake are determined by the types of financing available. Financial managers must ensure that funds are available when needed both now and in the future, that they are obtained at the lowest possible cost, and that they are used as efficiently as possible. In addition, proper financial management must also ensure that:

- Financing priorities are established in line with organizational goals and objectives;
- Spending is planned and controlled;
- A firm's credit customers pay their bills on time, and the number of past due accounts is reduced;
- Bills are paid promptly to protect the firm's credit rating and its ability to borrow money;
- The funds required for paying the firm's taxes are available when needed to meet tax deadlines; and
- Excess cash is invested in certificates of deposit (CDs), government securities, or conservative, marketable securities.

To encourage more responsible financial management, political leaders, the Securities and Exchange Commission (SEC), self-regulatory organizations like the Financial Industry Regulatory Authority (FINRA), and companies in the banking and financial industry often enact regulations and create guidelines that encourage legal and ethical behavior. Many security laws date back to the 1930s and were enacted to curb the abuses and practices that led to the Great Depression in 1929. Through the years more laws have been passed to strengthen regulation of the banking and finance industry. One of the more important laws enacted is the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was designed to create a sound economic foundation that would encourage job growth, rein in Wall Street and prohibit some speculative techniques, end financial bailouts, and prevent future financial crises. The Dodd-Frank Act also provided new regulations to protect American families from unfair and abusive financial and banking practices.

Even with the new regulations, some experts and politicians still argue current laws do not go far enough and there is a need for additional regulations and increased government oversight. For business firms, the impact of new laws could increase the time and cost of obtaining both short- and long-term financing.

financial management all the activities concerned with obtaining money and using it effectively

Ethics and Social Responsibility

Goldman Sachs Fined Billions for Foreign Bribery

Goldman Sachs Group Inc., a leader in global investment banking, securities, and investment management, and its Malaysian subsidiary admitted to conspiring to violate the anti-bribery provisions of the Foreign Corrupt Practices Act (FCPA). It was discovered that over a period of five years the company engaged in bribery by offering financial incentives to influence high-level government officials. Goldman Sachs agreed to pay more than $2.9 billion in U.S. fines as well an additional $3.9 billion to settle with the Malaysian government.

Goldman Sachs engaged in a scheme to pay more than $1 billion in bribes to government officials in Malaysia in exchange for approval to sell bonds to raise $6.5 billion that had been earmarked to help the people of Malaysia. Government approval enabled Goldman Sachs to earn profits for selling the bonds, but most of the money from the sale of the bonds benefited the country's leaders and their associates.

Several current and former top executives were implicated in the scandal. These individuals were required to return more than $174 million in pay and bonuses from prior years. Repayments like this are often referred to as a clawback. Tim Leissner, Goldman Sachs' former Southeast Asia chairman, pleaded guilty to conspiracy to violate the FCPA and conspiracy to commit money laundering. Ng Chong Hwa (also known as Roger Ng), former head of investment banking for Goldman Sachs Malaysia, was also charged with conspiracy to violate the FCPA and conspiracy to commit money laundering. Ng was extradited from Malaysia to face trial in the United States.

The scandal negatively impacted not only Goldman Sachs' reputation but also the reputation of other American financial institutions operating abroad. Experts also point out that this type of unethical behavior, which involves high-level executives, suggests a culture problem exists and undermines public confidence in American business in the United States and abroad.

Sources: Based on information in United States Department of Justice, "Goldman Sachs Resolves Foreign Bribery Case And Agrees To Pay Over $2.9 Billion," October 22, 2020, www.justice.gov/usao-edny/pr/goldman-sachs-resolves-foreign-bribery-case-and-agrees-pay-over-29-billion; "Goldman to Pay Nearly $3 Billion Fine Following Foreign Bribes Probe," *CBS News*, October 23, 2020, www.cbsnews.com/news/goldman-sachs-to-pay-3-billion-fine-foreign-bribes-1mdb-probe; Matthew Goldstein and Emily Flitter, "Goldman Sachs Malaysia Arm Pleads Guilty in 1MDB Fraud," *The New York Times*, October 22, 2020, www.nytimes.com/2020/10/22/business/goldman-sachs-fraud-guilty-plea.html.

16-1b **Careers in Finance**

Financial
Plan

JASNI/SHUTTERSTOCK.COM

Careers in the financial services industry are on the rise! Between now and 2029, jobs in finance are expected to increase 15 percent—that's much faster than the average growth for other industries. As an added bonus, employees enjoy higher salaries and increased benefits when compared to careers in other industries. You can find more information for this career and other options by exploring the information available in the Occupational Outlook Handbook at https://www.bls.gov/ooh/.

A career in finance can be rewarding. As an added bonus, the Bureau of Labor Statistics projects there will be a 15 percent increase in the number of jobs in the financial sector of the economy between now and 2029.[3] People in finance must have certain traits and skills. One of the most important priorities for someone interested in a finance career is honesty. Be warned: Investors, lenders, government regulators, and other corporate executives expect financial managers to be above reproach. In addition to honesty, managers and employees in the finance area must:

1. Have a strong background in finance, accounting, or mathematics.
2. Know how to use a computer to analyze data.
3. Be an expert at both written and oral communication.

Today, there are many different types of positions in finance. Typical job titles include chief financial officer, vice president of finance, bank officer, consumer credit officer, financial analyst, financial planner, loan officer, insurance analyst, and investment account executive. Depending on qualifications, work experience, and education, salaries generally are higher in the financial industry when compared with careers in other industries. Many employees also have excellent benefits and other perks that make a career in financial management attractive.

✓ Concept Check

- For a business firm, what type of activities does financial management involve?
- To be successful, what traits and skills does an employee in the finance industry need?

16-2 The Need for Financing

Learning Objective

16-2 Identify a firm's short- and long-term financial needs.

Money is needed both to start a business and to keep it going. The original investment of the owners, along with money they may have borrowed, should be enough to open the doors. After that, ideally sales revenues should be used to pay the firm's expenses and provide a profit as well.

This is exactly what happens in a successful firm—over the long run. However, income and expenses may vary from month to month or from year to year. Short-term financing may be needed when sales are low and expenses are high. For example, many businesses experienced lower sales during the COVID-19 pandemic, but still had expenses and bills that had to be paid. On the other hand, long-term financing may be needed to open new retail locations, to purchase equipment, or to build a new plant. For example, management at Cincinnati-based Graeter's Ice Cream—the company profiled in the end-of-part cases for this text—recognized they needed long-term financing to build a new plant and buy out an existing franchisee. To see how management financed both opportunities, read the case in the "Running a Business" section in Part 6.

16-2a Short-Term Financing

Short-term financing is money that will be used for one year or less. As illustrated in Table 16-1, there are many short-term financing needs, but three deserve special attention. First, certain business practices may affect a firm's cash flow and create a need for short-term financing. **Cash flow** is the movement of money into and out of an organization. The goal is to have sufficient money coming into the firm in any period to cover the firm's expenses during that period. This goal, however, is not always achieved. For example, California-based Callaway Golf offers credit to retailers that carry the firm's golf clubs, balls, clothing, and golf accessories. Credit purchases made by Callaway's retailers generally are not paid until 30 to 60 days (or more) after the transaction. Callaway therefore may need short-term financing to solve its cash flow problem and to pay its bills until its customers have paid theirs.

A second need for short-term financing is speculative production. **Speculative production** refers to the production of goods which is followed by a time lag before the actual sale of those goods. Consider what happens when a firm such as Connecticut-based Stanley Black & Decker begins to manufacture power and small hand tools for sale during the Christmas season. Manufacturing begins in March, April, and May, and the firm negotiates short-term financing to buy materials and

Table 16-1 Comparison of Short- and Long-Term Financing

Whether a business seeks short- or long-term financing depends on what the money will be used for.

Short-Term Financing Needs	Long-Term Financing Needs
Cash-flow problems	Business start-up costs
Speculative production	Mergers and acquisitions
Current inventory needs	New product development
Monthly expenses	Long-term marketing activities
Short-term promotional needs	Replacement of equipment
Unexpected emergencies	Expansion of facilities

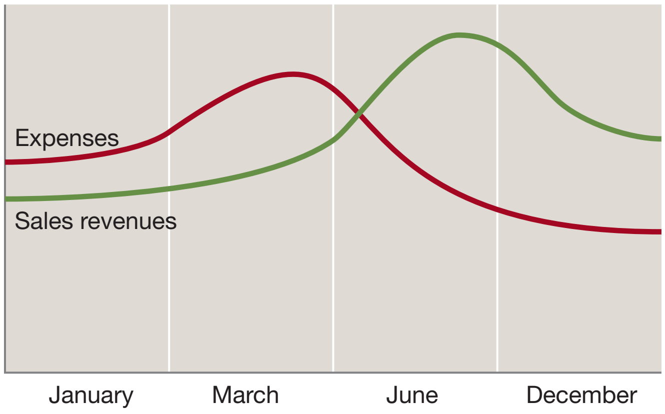
short-term financing money that will be used for one year or less

cash flow the movement of money into and out of an organization

speculative production the production of goods which is followed by a time lag before the actual sale of those goods

Figure 16-2 Cash Flow for a Manufacturing Business

Manufacturers such as Stanley Black & Decker often use short-term financing to pay expenses during the production process. Once goods are shipped to retailers and wholesalers and payment is received, sales revenues are used to repay short-term financing.



supplies, to pay wages and rent, and to cover inventory costs until its products eventually are sold to wholesalers and retailers later in the year. Take a look at Figure 16-2. Although Stanley Black & Decker manufactures and sells finished products all during the year, expenses peak during the first part of the year. During this same period, sales revenues are low. Once the firm's finished products are shipped to retailers and wholesalers and payment is received (usually within 30 to 60 days), sales revenues are used to repay short-term financing.

A third need for short-term financing is to increase inventory. Retailers that range in size from Walmart to the neighborhood drugstore need short-term financing to build up their inventories before peak selling periods. For example, Dallas-based Bruce Miller Nurseries must increase the number of shrubs, trees, and flowering plants that it makes available for sale during the spring and summer growing seasons. To enable Bruce Miller to obtain the merchandise inventory it needs, growers and wholesalers extend the repayment period. Then once the merchandise is sold, Bruce Miller repays the growers and wholesalers.

16-2b Long-Term Financing

Long-term financing is money that will be used for longer than one year. Long-term financing obviously is needed to start a new business. As Table 16-1 shows, it is also needed for business mergers and acquisitions, new product development, long-term marketing activities, replacement of equipment that has become obsolete, and expansion of facilities.

long-term financing money that will be used for longer than one year

The amounts of long-term financing needed by large firms can seem almost unreal. Intel—a leader in the technology industry with a long history of investing in research and development—spent over $13.5 billion in 2020 to develop new technology that is used to produce state-of-the art electronic devices.[4]

REWARD
RISK

ELNUR/SHUTTERSTOCK.COM

16-2c The Risk–Return Ratio

According to financial experts, business firms will find it more difficult to raise both short- and long-term financing in the future for two reasons. First, financial reform and increased government regulations

✓ Concept Check

- How does short-term financing differ from long-term financing? Give two business uses for each type of financing.
- What is speculative production? How is it related to a firm's cash-flow problems?
- As an employee in the finance department of a large company, how would you explain the risk–return ratio to an investor?

will lengthen the process required to obtain financing. Second, both investors and lenders are more cautious about who receives financing. As a result of these two factors, financial managers must develop a strong financial plan that describes how the money will be used and how it will be repaid. When developing a financial plan for a business, a financial manager must also consider the risk–return ratio when making decisions that affect the firm's finances. The **risk–return ratio** is based on the principle that a high-risk decision should generate higher financial returns for a business. On the other hand, more conservative decisions (with less risk) often generate lesser returns. Although financial managers want higher returns, they often must strive for a balance between risk and return. For example, Ohio-based American Electric Power is investing billions of dollars to fund research into renewable energy sources including wind and solar technology. Yet, financial managers (along with other executives and managers throughout the organization) must evaluate the potential return before committing to such a costly project.

16-3 Planning—The Basis of Sound Financial Management

Learning Objective

16-3 Summarize the process of planning for financial management.

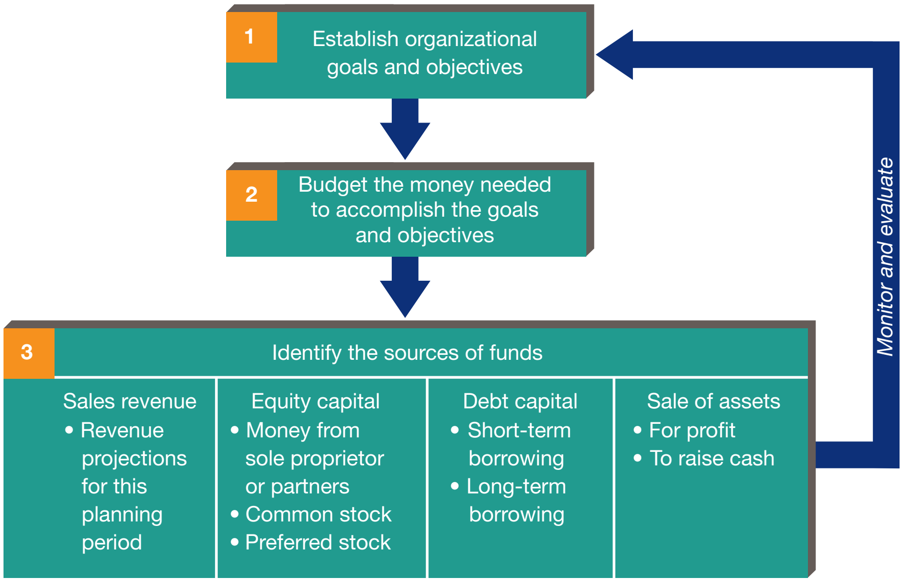
In Chapter 6, we defined a *plan* as an outline of the actions by which an organization intends to accomplish its goals and objectives. A **financial plan**, then, is a plan for obtaining and using the money needed to implement an organization's goals and objectives.

16-3a Developing the Financial Plan

Financial planning (like all planning) begins with establishing a set of valid goals and objectives. Financial managers must then determine how much money is needed to accomplish each goal and objective. Finally, financial managers must identify available sources of financing and decide which to use. The three steps involved in financial planning are illustrated in Figure 16-3.

Figure 16-3 The Three Steps of Financial Planning

After a financial plan has been developed, it must be monitored continually to ensure that it actually fulfills the firm's goals and objectives.


1
Establish organizational goals and objectives
2
Budget the money needed to accomplish the goals and objectives
3
Identify the sources of funds
Sales revenue
• Revenue projections for this planning period
Equity capital
• Money from sole proprietor or partners
• Common stock
• Preferred stock
Debt capital
• Short-term borrowing
• Long-term borrowing
Sale of assets
• For profit
• To raise cash
Monitor and evaluate

risk–return ratio a ratio based on the principle that a high-risk decision should generate higher financial returns for a business and more conservative decisions often generate lower returns

financial plan a plan for obtaining and using the money needed to implement an organization's goals and objectives

Establishing Organizational Goals and Objectives As pointed out in Chapter 6, a *goal* is an end result that an organization expects to achieve over a one- to ten-year period. An *objective* was defined in Chapter 6 as a specific statement detailing what an organization intends to accomplish over a shorter period of time. If goals and objectives are not specific and measurable, they cannot be translated into dollar costs, and financial planning cannot proceed. For large corporations, both goals and objectives can be expensive. For example, have you ever wondered how much McDonald's spends on advertising? Well, to reach almost 70 million customers that it serves each day, the world's most famous fast-food restaurant chain spends over $600 million each year.[5]

WAYHOME STUDIO/SHUTTERSTOCK.COM

Do you have a budget? After establishing goals and objectives, a successful business takes the next step and constructs a budget to project revenues, expenses, or both for a specified period of time. You, just like a business, can do the same thing and build a budget to help you manage your personal finances and achieve your short- and long-term goals.

Budgeting for Financial Needs Once planners know what the firm's goals and objectives are for a specific period—say, the next calendar year—they can construct a budget that projects the costs the firm will incur and the sales revenues it will receive. Specifically, a **budget** is a financial statement that projects income, expenditures, or both over a specified future period.

Usually, the budgeting process begins with the construction of departmental budgets for sales and various types of expenses. Financial managers can easily combine each department's budget for sales and expenses into a company-wide cash budget. A **cash budget** estimates cash receipts and cash expenditures over a specified period. Notice in the cash budget for Stars and Stripes Clothing, shown in Figure 16-4, cash sales and collections are listed at the top for each calendar quarter. Payments for purchases and routine expenses are listed in the middle section. Using this information, it is possible to calculate the anticipated cash gain or loss at the end of each quarter for this retail clothing store.

Most firms today use one of two approaches to budgeting. In the *traditional* approach, each new budget is based on the dollar amounts contained in the budget for the preceding year. These amounts are modified to reflect any revised goals,

budget a financial statement that projects income, expenditures, or both over a specified future period

cash budget a financial statement that estimates cash receipts and cash expenditures over a specified period

Figure 16-4 Cash Budget for Stars and Stripes Clothing

A company-wide cash budget projects cash sales, collections, purchases, and expenses over a specified period to anticipate cash gains and losses.

STARS AND STRIPES CLOTHING
Cash Budget
From January 1, 20xx to December 31, 20xx

	First Quarter ($)	Second Quarter ($)	Third Quarter ($)	Fourth Quarter ($)	Total ($)
Cash sales and collections	150,000	160,000	150,000	185,000	645,000
Less payments					
Purchases	110,000	80,000	90,000	60,000	340,000
Wages/salaries	25,000	20,000	25,000	30,000	100,000
Rent	10,000	10,000	12,000	12,000	44,000
Other expenses	4,000	4,000	5,000	6,000	19,000
Taxes	8,000	8,000	10,000	10,000	36,000
Total payments	157,000	122,000	142,000	118,000	539,000
Cash gain or (loss)	(7,000)	38,000	8,000	67,000	106,000

and managers are required to justify only new expenditures. The problem with this approach is that it leaves room for padding budget items to protect the (sometimes selfish) interests of managers or their department. This problem is essentially eliminated through zero-base budgeting. **Zero-base budgeting** is a budgeting approach in which every expense in every budget must be justified.

To develop a plan for long-term financing needs, managers often construct a capital budget. A **capital budget** estimates a firm's expenditures for major assets, including new product development, expansion of facilities, replacement of obsolete equipment, and mergers and acquisitions. For example, Uber—a company known for providing consumers with ride services and food delivery—acquired Postmates—a food delivery competitor. Uber constructed a capital budget to determine if it should pay cash or offer stock to pay for the smaller company. Uber chose to use the stock option and no cash outlay was required.[6]

Identifying Sources of Funds The four primary sources of funds, listed in Figure 16-3, are sales revenue, equity capital, debt capital, and proceeds from the sale of assets. Future sales revenue generally provides the greatest part of a firm's financing. Figure 16-4 shows that for Stars and Stripes Clothing, sales for the year are expected to cover all expenses and to provide a cash gain of $106,000. However, Stars and Stripes has a problem in the first quarter, when sales are expected to fall short of expenses by $7,000. In fact, one of the primary reasons for financial planning is to provide management with adequate lead time to solve this type of cash-flow problem.

zero-base budgeting a budgeting approach in which every expense in every budget must be justified

capital budget a financial statement that estimates a firm's expenditures for major assets and its long-term financing needs

Exploring Careers

How to Become a CFO

A chief financial officer (CFO) is a senior-level executive that manages a company's finances. As the overseer of the finance and accounting divisions, the CFO is responsible for planning how to finance the firm's activities, borrowing money when needed, managing cash flow, ensuring financial statements and tax returns are accurate, and even paying bills to protect the firm's credit rating. In addition to making important financial decisions, a CFO must help other high-level managers make decisions that could often make or break the business.

There is not just one route to becoming a CFO. Previous job titles often include senior financial controller, director of finance, or treasurer. To be successful, CFOs must have a working knowledge of accounting, financial analysis, risk management, regulatory compliance, investments, and budgeting. A broad understanding of business management, operations management, and retailing is also helpful.

For many CFOs, preparation begins with college courses in accounting or finance that eventually lead to a bachelor's or master's degree in business administration, accounting, or finance. A working knowledge of computers, software, and technology can also help process the data and information a CFO needs to make important decisions. In addition to these skills, the ability to communicate and work with people and to use critical thinking skills to solve problems are valuable skills for a CFO executive.

Following the CFO career path can be both rewarding and challenging. The average base salary for a CFO is more than $136,000, but salaries can be much higher in large corporations. Executives at this level also have excellent benefits and retirement packages. While this is a highly-paid position, it also comes with great responsibility. This important role is reserved for professionals with established track records, broad business experience, and a deep understanding of finance.

Sources: Based on information in "How to Become a CFO – 7 Steps to Guide Your Career Path," *Robert Half,* March 2020, www.roberthalf.com.sg/blog/jobseekers/how-become-cfo-7-steps-guide-your-career-path; Mitchell Grant, "Chief Financial Officer (CFO)," *Investopedia*, February 28, 2021, www.investopedia.com/terms/c/cfo.asp; "Average Chief Financial Officer (CFO) Salary," *PayScale*, March 18, 2021, www.payscale.com/research/US/Job=Chief_Financial_Officer_(CFO)/Salary.

A second type of funding is **equity capital**. For a sole proprietorship or partnership, equity capital is provided by the owner or owners of the business. For a corporation, equity capital is money obtained from the sale of shares of ownership in the business. Equity capital is used almost exclusively for long-term financing.

A third type of funding is **debt capital**, which is borrowed money. Debt capital may be borrowed for either short- or long-term use—and a short-term loan seems made to order for Stars and Stripes Clothing's shortfall problem. The firm probably would borrow the needed $7,000 (or perhaps a bit more) at some point during the first quarter and repay it from second-quarter sales revenue.

Proceeds from the sale of assets are the fourth type of funding. Selling assets is often a drastic step. However, it may be a reasonable last resort when sales revenues are declining, and equity capital or debt capital cannot be found. Assets also may be sold to increase a firm's cash balance or when they are no longer needed or do not "fit" with the company's core business. Berkshire Hathaway sold its newspaper holdings to Lee Enterprises for $140 million. Berkshire Hathaway—a corporate giant—can use the proceeds of the sale to acquire other companies with more potential.[7]

16-3b Monitoring and Evaluating Financial Performance

It is important to ensure that financial plans are implemented properly and to catch potential problems before they become major ones. Despite efforts to raise additional financing, reduce expenses, and increase sales to become profitable, retailer JCPenney filed for bankruptcy in 2020 and closed over 150 stores or about 15 percent of its retail locations.[8] To prevent such problems, financial managers should establish a means of monitoring financial performance. Interim budgets (weekly, monthly, or quarterly) may be prepared for comparison purposes. These comparisons highlight areas that require additional or revised planning—or at least areas calling for a more careful investigation. Budget comparisons can also be used to improve the firm's future budgets.

✓ Concept Check

- What is the function of a cash budget? A capital budget?
- What is the difference between equity capital and debt capital?
- Describe the four sources of funds for a business.
- How does a financial manager monitor and evaluate a firm's financing?

16-4 Financial Services Provided by Banks and Other Financial Institutions

Learning Objective

16-4 Identify the services provided by banks and financial institutions for their business customers.

For a business owner, it helps to know your banker. Banking services can be divided into three broad categories: traditional services, electronic banking services, and international services.

16-4a Traditional Banking Services for Business Clients

Traditional services provided by banks and other financial institutions include savings and checking accounts, loans, processing credit card and debit card transactions, and providing professional advice.

Savings and Checking Accounts Savings accounts provide a safe place to store money a business doesn't immediately need. The usual *passbook savings account* earns between 0.05 and 0.25 percent in most financial institutions. A business with excess cash it is willing to leave on deposit with a bank for a set period of time can earn a higher rate of interest. To do so, the business firm buys a certificate of deposit. A **certificate of deposit (CD)** is a document stating that the bank will pay the depositor a guaranteed interest rate on money left on deposit for a specified period of time. At the time of publication, one-year CDs were paying between 0.25 and 1.10 percent. The rate can vary depending on the financial institution and the amount of time until maturity.

equity capital money received from the owners or from the sale of shares of ownership in a business

debt capital borrowed money obtained through loans of various types

certificate of deposit (CD) a document stating that the bank will pay the depositor a guaranteed interest rate on money left on deposit for a specified period of time

ISABELLE OHARA/SHUTTERSTOCK.COM

For a business, a relationship with a banker can mean the difference between success and failure. Although JP Morgan Chase—often referred to as Chase—is the largest bank in the United States, it still must meet the needs of its customers. Like many competitors, Chase offers the services a business (or an individual) needs to manage their finances, including savings and checking accounts, short- and long-term loans, credit and debit card processing, and financial advice.

Business firms (and individuals) also deposit money in checking accounts so that they can write checks to pay for purchases. For businesses, monthly charges are based on the average daily balance in the checking account and/or the number of checks written.

Business Loans Banks, savings and loan associations, credit unions, and other financial institutions provide short- and long-term loans to businesses. *Short-term business loans* must be repaid within one year or less. To help ensure that short-term money will be available when needed, many firms establish a line of credit. A **line of credit** is a loan that is approved before the money is actually needed. Because all the necessary paperwork is already completed and the loan is preapproved, the business can obtain the money later without delay, as soon as it is required. Even with a line of credit, a firm may not be able to borrow money if the bank does not have sufficient funds available. For this reason, some firms prefer a **revolving credit agreement**, which is a guaranteed line of credit. Under this type of agreement, the bank guarantees that the money will be available when the borrower needs it. In return for the guarantee, the bank may charge a commitment fee. Typical commitment fees range from 0.25 to 1.0 percent of the *unused* portion of the revolving credit agreement. The usual interest rate is charged for the portion that *is* borrowed.

Long-term business loans are repaid over a period of years. The average length of a long-term business loan is generally 3 to 7 years but sometimes as long as 15 to 20 years. Loans to purchase real estate may even be as long as 30 years. Most lenders require some type of collateral for long-term loans. **Collateral** is real estate or property (e.g., stocks, bonds, equipment, or any other asset of value) pledged as security for a loan.

Repayment terms and interest rates for both short- and long-term loans are arranged between the lender and the borrower. For businesses, repayment terms may include monthly, quarterly, semiannual, or annual payments.

The Basics of Getting a Loan According to many financial experts, preparation is the key when applying for a business loan. To begin the process, you should get to know potential lenders before requesting a loan. Although there may be many potential lenders that can provide the money you need, the logical place to borrow money is where your business does its banking. Before applying for a loan, you may also want to check your firm's credit rating with a national credit bureau such as Dun & Bradstreet (sometimes referred to as D&B). Typically, business owners will be asked to fill out a loan application. In addition to the loan application, the lender will also want to see your current business plan. Be sure to explain how much funding you require to accomplish your goals and how the loan will be repaid. Most lenders insist that you submit current financial statements that have been prepared by an independent certified public accountant. Then compile a list of references that includes your suppliers, other lenders, or the professionals with whom you are associated. You may also be asked to discuss the loan request with a loan officer. Hopefully, your loan request will be approved. If not, try to determine why your loan request was rejected. Think back over the loan process and determine what you could do to improve your chances of getting a loan the next time you apply.

line of credit a loan that is approved before the money is actually needed

revolving credit agreement a guaranteed line of credit

collateral real estate or property pledged as security for a loan

Technology and Innovation

Mastercard Advances Its Open Banking Strategy

Though Mastercard is often thought of as simply a credit card company, this multinational corporation is actually a technology company that specializes in financial services and global payment solutions. The company's consumer payment products include credit, debit, and prepaid cards. For businesses, Mastercard offers a variety of products and payment solutions such as secure payment systems that protect customers and merchants, co-branded cards, business-to-business (B2B) payment services, and more. It is also a leader in developing open banking.

The concept of open banking refers to sharing financial information electronically and securely with other businesses. To strengthen its open banking platform, Mastercard acquired Finicity for $825 million. Finicity is a company that has a history of helping consumers and organizations use financial data and technology to make better decisions. For Mastercard, the acquisition is another way to use a competitive edge over competitors like Visa, American Express, and Discover. At the same time, financial information gathered by Finicity will help connect consumers with companies—especially lenders—that need accurate, real time data to approve or reject credit applications. To illustrate how open banking can speed the loan approval process, consider the following example. A couple wants to buy a home, but they need financing. They apply for a loan from a lender like Rocket Mortgage. By accessing real-time data from Finicity, Rocket Mortgage obtains the financial data it needs to evaluate the couple's ability to repay the loan without having to go to multiple sources. Because of open banking, the time required to approve or reject a loan request can be reduced, which is an advantage for both the borrower and the lender.

Mastercard—the parent company of Finicity—believes that open banking platforms that use technology will become even more important as the financial industry continues to innovate and use technology to provide improved service to both consumers and merchants around the globe. Although open banking on a global scale can be challenging because every country has its own set of financial rules and regulations, Mastercard has already developed plans to expand its open banking solutions outside of the United States and Europe.

Sources: Based on information in Anna Hrushka, "Mastercard Deal Brings Finicity to Global Stage, CEO Says," *Banking Dive*, July 17, 2020, www.bankingdive.com/news/mastercard-finicity-steve-smith/581840; Mastercard, "Mastercard Extends Open Banking Efforts with Close of Finicity Acquisition," November 19, 2020, www.mastercard.com/news/press/2020/november/mastercard-extends-open-banking-efforts-with-close-of-finicity-acquisition; "DOJ Approves Mastercard's $825M Acquisition Of Finicity," *PYMNTS*, November 16, 2020, www.pymnts.com/news/partnerships-acquisitions/2020/doj-approves-mastercard-finicity-acquisition.

16-4b Debit and Credit Card Transactions and Mobile Pay

Today, customers have multiple ways to pay for merchandise and services. According to a recent Federal Reserve System survey that tracked payments made by more than 3,000 individuals over a three-day period, debit cards were used most often to pay for purchases followed by cash, credit cards, electronic payments, and checks—refer to Table 16-2.[9] Each of the payment options requires a business to set up procedures and work with banks and other financial institutions in order to process payments for merchandise and services. A **debit card** is a card that electronically subtracts the amount of the purchase from a customer's bank account at the moment the purchase is made. For example, when you use a debit card to pay for lunch at Olive Garden, the restaurant must use electronic equipment to process the debit card transaction before funds are deposited in the restaurant's account. Note: Don't confuse debit cards with credit cards. Although they may look alike, there are important differences. A debit card electronically subtracts the amount of a customer's purchase from a bank account at the moment the purchase is made. If you use a credit card to pay for your purchase, the credit card company extends short-term financing, and you do not make payment until you receive your next statement.

debit card a card that electronically subtracts the amount of a purchase from a customer's bank account at the moment the purchase is made

Table 16-2 **Consumer Payment Options**

Although there are many ways to pay for merchandise and services, most people prefer using debit cards.

Payment Option	Percentage of People Who Prefer This Option
Debit cards	30 Percent
Cash	26 percent
Credit cards	24 percent
Electronic payments	11 percent
Checks	5 percent

Source: Laura Kim, Raynil Kumar, and Shaun O'Brien, "2020 Findings from the Diary of Consumer Payment Choice," Federal Reserve Bank of San Francisco, https://www.frbsf.org/cash/publications/fed-notes/2020/july/2020-findings-from-the-diary-of-consumer-payment-choice/ (accessed July 31, 2020).

Consumers also use credit cards to pay for everything from tickets on American Airlines to Zebco fishing gear. Recent statistics published by CardRates.com indicate that 61 percent of Americans have at least one credit card. And on average Americans have four cards. More importantly, 75 percent of consumers with credit cards carry an average balance of more than $6,200.[10] Still, merchants accept and even encourage customers to use credit cards to pay for their purchases. The reason is simple: Often consumers that don't have the cash to make a purchase will use a credit card to make the purchase. For example, many consumers used their credit cards to purchase everyday necessities in the spring of 2020 when the number of unemployed workers increased to record levels as a result of the temporary closure of nonessential businesses during the first phase of the COVID-19 pandemic.

By depositing credit transaction slips in a bank or other financial institution, the merchant can convert card sales into cash. In return for processing the merchant's card transactions, the financial institution charges a fee that generally ranges between 1 and 3.5 percent. The number of card transactions, the total dollar amount of debit and credit sales, and how well the merchant can negotiate the fees the financial institution charges determine actual fees. Typically, small, independent businesses pay more than larger stores or chain stores.

In addition to debit and credit cards, mobile payments are now accepted by many businesses. **Mobile payments** allow customers to use an electronic device or app to pay for a product or service. The most common electronic devices used to complete mobile payments are cell phones or tablets. Examples of mobile payment systems are Apple Pay, PayPal, and Google Pay. For merchants, processing a mobile payment is similar to processing debit card transactions. For customers, mobile pay is convenient and often safer than carrying plastic debit or credit cards. Most experts agree that mobile payments and other electronic payment methods will become even more popular in the future.

16-4c Electronic Banking Services

An **electronic funds transfer (EFT) system** is a means of performing financial transactions through a computer terminal. The following four EFT applications are changing how banks and financial institutions help firms do business:

1. *Automated teller machines (ATMs)*. An ATM is an electronic bank teller—a machine that provides many of the same services a human teller can provide. Once the customer is properly identified, the machine dispenses cash from the customer's checking or savings account or makes a cash advance charged to a credit card. Customers have access to ATMs at all times of the day or night. There may be a fee for each transaction.
2. *Automated clearinghouses (ACHs)*. Designed to reduce the number of paper checks, automated clearinghouses process checks, direct deposits, recurring

mobile payment payment for a product or service which is made using an electronic device or an app

electronic funds transfer (EFT) system a means of performing financial transactions through a computer terminal bill payments, Social Security benefits, and employee salaries. For example, large companies use the ACH network to transfer salaries directly into their employees' bank accounts, thus eliminating the need to make out individual paychecks.

3. *Point-of-sale (POS) terminals.* A POS terminal is a computerized cash register located in a retail store. Assume you want to pay for purchases at a Walmart Supercenter. You begin the process by pulling your credit or debit card through a magnetic card reader or inserting your card into the chip reader. A central processing center notifies a computer at your bank that you want to make a purchase. The bank's computer immediately adds the amount to your credit card account for a credit transaction. In a similar process, the bank's computer deducts the amount of the purchase from your bank checking account if you use a debit card. Finally, the amount of your purchase is added to the store's account. The Walmart store then is notified that the transaction is complete, and the cash register prints out your receipt. A POS system can also collect customer information for a marketing database and provide sales information for a firm's inventory system.
4. *Electronic check conversion (ECC).* Electronic check conversion is a process used to convert information from a paper check into an electronic payment for merchandise, services, or bills. When you give your completed check to a store cashier at a Best Buy store, the check is processed through an electronic system that captures your banking information and the dollar amount of the check. Once the check is processed, the funds to pay for your transaction are transferred into the business firm's account. Finally, you are asked to sign a receipt, and you get a voided (canceled) check back for your records. ECC also can be used for checks you mail to pay for a purchase or to pay on an account.

EFTs are fast, and they eliminate the costly processing of paper checks. However, some customers are reluctant or afraid to use online banking or EFT systems because they fear the computer will garble their accounts. Others are afraid someone will steal their account information. Early on, Congress responded to such fears by passing the Fair Credit Billing Act and the Electronic Funds Transfer Act, which protect the customer in case the bank makes an error or the customer's credit or debit card is stolen.

16-4d **International Banking Services**

For international businesses, banking services are extremely important. Depending on the needs of an international firm, a bank can help by providing a letter of credit or a banker's acceptance.

A **letter of credit** is a legal document issued by a bank or other financial institution guaranteeing to pay a seller a stated amount for a specified period of time if certain conditions or requirements are met. In most cases, a letter of credit is valid for 30 to 60 days. With a letter of credit, certain conditions or requirements, such as proof of shipment or delivery of the merchandise, may be specified before payment is made.

A **banker's acceptance** is a written order for a bank to pay a third party a stated amount of money on a specific date. With a banker's acceptance, no conditions or requirements are specified. It is simply an order to pay without any strings attached.

Both a letter of credit and a banker's acceptance are popular methods of paying for import and export transactions. Imagine that you are a business owner in the United States who wants to purchase some leather products from a small business in Florence, Italy. You offer to pay for the merchandise with your company's check drawn on an American bank, but the Italian business owner is worried about payment. To solve the problem, your bank can issue either a letter

letter of credit a legal document issued by a bank or other financial institution guaranteeing to pay a seller a stated amount for a specified period of time if certain conditions or requirements are met

banker's acceptance a written order for a bank to pay a third party a stated amount of money on a specific date

✓ Concept Check

- Describe the traditional banking services provided by financial institutions.
- What are the major advantages of electronic banking services?
- How can a bank or other financial institution help American businesses to compete in the global marketplace?

of credit or a banker's acceptance to guarantee that payment will be made. In addition to a letter of credit and a banker's acceptance, banks also can use EFT technology to speed international banking transactions.

One other international banking service should be noted. Banks and other financial institutions provide for currency exchange. If you place an order with a Japanese manufacturer for merchandise valued at $50,000, how do you pay for the order? Do you use U.S. dollars or Japanese yen? To solve this problem, you can use the bank's currency-exchange service. To make payment, you can use either currency, and if necessary, the bank will exchange one currency for the other to complete your transaction.

16-5 Sources of Short-Term Debt Financing

Learning Objective

16-5 Describe the advantages and disadvantages of different methods of short-term debt financing.

The decision to borrow money does not necessarily mean that a firm is in financial trouble. On the contrary, astute financial management often means regular, responsible borrowing of many different kinds to meet different needs. In this section, we examine the sources of *short-term debt financing* available to businesses. In the next two sections, we look at long-term financing options: equity capital and debt capital.

16-5a Sources of Unsecured Short-Term Financing

Short-term debt financing is usually easier to obtain than long-term debt financing for three reasons:

1. For the lender, the shorter repayment period means less risk of nonpayment.
2. The dollar amounts of short-term loans are usually smaller than those of long-term loans.
3. A close working relationship normally exists between the short-term borrower and the lender.

Most lenders do not require collateral for short-term financing. Remember in the last section that *collateral* was defined as real estate or property pledged as security for a loan. If they do require collateral, it is usually because they are concerned about the size of a particular loan, the borrowing firm's poor credit rating, or the general prospects of repayment.

Unsecured financing is financing that is not backed by collateral. A company seeking unsecured short-term financing has several options.

Trade Credit Manufacturers and wholesalers often provide financial aid to their customers by allowing them 30 to 60 days (or more) in which to pay for merchandise. This delayed payment, known as **trade credit**, is a type of short-term financing extended by a seller who does not require immediate payment after delivery of merchandise. It is the most popular form of short-term financing because most manufacturers and wholesalers do not charge interest for trade credit. In fact, from 70 to 90 percent of all transactions between businesses involve some trade credit.

Assume that Walmart receives a shipment of clothing from a manufacturer. Along with the merchandise, the manufacturer sends an invoice that states the terms of payment. Walmart now has two options for payment. First, it may pay the invoice promptly and take advantage of any cash discount the manufacturer offers. Cash-discount terms are specified on the invoice. For instance, "2/10, net 30" means that the customer—Walmart—may take a 2 percent discount if it pays the invoice within 10 days of the invoice date.

A second option is to wait until the end of the credit period before making payment. If payment is made between 11 and 30 days after the date of the invoice,

unsecured financing financing that is not backed by collateral

trade credit a type of short-term financing extended by a seller who does not require immediate payment after delivery of merchandise

Walmart must pay the entire amount. As long as payment is made before the end of the credit period, the business maintains the ability to purchase additional merchandise from the seller using the trade-credit arrangement.

Promissory Notes Issued to Suppliers A **promissory note** is a written pledge by a borrower to pay a certain sum of money to a creditor at a specified future date. Suppliers uneasy about extending trade credit may be less reluctant to offer credit to customers who sign promissory notes. Unlike trade credit, however, promissory notes usually require the borrower to pay interest. Although repayment periods may extend to one year, most short-term promissory notes are repaid in 60 to 180 days.

A promissory note offers two important advantages to the firm extending the credit.

1. A promissory note is legally binding and an enforceable contract.
2. A promissory note is a negotiable instrument.

Because a promissory note is negotiable, the manufacturer, wholesaler, or company extending credit may be able to discount, or sell, the note to its own bank (or another business). If the note is discounted, the dollar amount received by the company extending credit is slightly less than the maturity value because the bank charges a fee for the service. The company extending credit recoups most of its money immediately, and the bank collects the entire amount when the note matures.

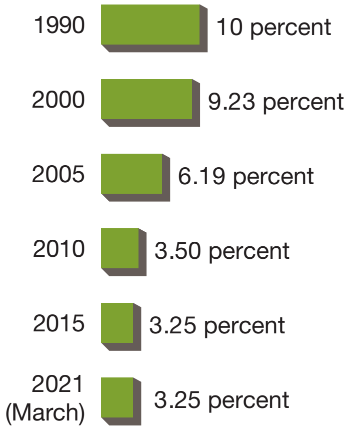
ROZENSKIP/SHUTTERSTOCK.COM

In 1950, Sam Walton opened a dime store called Walton's in Bentonville Arkansas. Then, in 1962, Mr. Walton opened the first Walmart Discount store in Rogers, Arkansas. Today, Walmart is the largest retailer in the world. A great deal of the retailer's success is built on its relationship with more than 2,800 suppliers that allow Walmart to use trade credit to purchase merchandise and then pay for it 30 to 60 days or more after the merchandise is sold in its stores.

Unsecured Bank Loans Banks and other financial institutions offer unsecured short-term loans to businesses at interest rates that vary with each borrower's credit rating. The **prime interest rate** is the lowest rate charged by a bank for a short-term loan. Figure 16-5 traces the fluctuations in the average prime rate

Figure 16-5 Average Prime Interest Rate Paid by U.S. Businesses, 1990–March 2021

The prime rate is the interest rate charged by U.S. banks when businesses with the "best" credit ratings borrow money. All other businesses pay higher interest rates than the prime rate.



Source: Federal Reserve Bank, www.federalreserve.gov (accessed March 4, 2021).

promissory note a written pledge by a borrower to pay a certain sum of money to a creditor at a specified future date

prime interest rate the lowest rate charged by a bank for a short-term loan charged by U.S. banks from 1990 to March 2021. This lowest rate generally is reserved for large corporations with excellent credit ratings. Organizations with good to high credit ratings may pay the prime rate plus 2 percent. Firms with questionable credit ratings may have to pay the prime rate plus 4 percent. Of course, if the banker believes that loan repayment may be a problem, the borrower's loan application may be rejected.

When a business obtains a short-term bank loan, interest rates and repayment terms may be negotiated. As a condition of the loan, a bank may require that a *compensating balance* be kept on deposit at the bank. Compensating balances, if required, are typically 10 to 20 percent of the borrowed funds. The bank may also require that every commercial borrower pay off its short-term loans at least once each year and not use short-term borrowing again for a period of 30 to 60 days.

Commercial Paper Large firms with excellent credit reputations like Microsoft, Procter & Gamble, and General Motors Acceptance Corporation can raise large sums of money quickly by issuing commercial paper. **Commercial paper** is a short-term promissory note issued by a large corporation. The maturity date for commercial paper is normally 270 days or less.

Commercial paper is secured only by the reputation of the issuing firm; no collateral is involved. The interest rate a corporation pays when it sells commercial paper is tied to its credit rating and its ability to repay the commercial paper. In most cases, corporations selling commercial paper pay interest rates below the interest rates charged by banks for short-term loans. Thus, selling commercial paper is cheaper than getting short-term financing from a bank.

Although it is possible to purchase commercial paper in smaller denominations, larger amounts—$100,000 or more—are quite common. Money obtained by selling commercial paper is most often used to purchase inventory, finance a firm's accounts receivables, pay salaries and other necessary expenses, and solve cash-flow problems.

16-5b Sources of Secured Short-Term Financing

If a business cannot obtain enough money through unsecured financing, it must put up collateral to obtain additional short-term financing. Almost any asset can serve as collateral. However, *inventories* and *accounts receivable* are the assets most commonly pledged for short-term financing. Even when it is willing to pledge collateral to back up a loan, a firm that is financially weak may have difficulty obtaining short-term financing or its loan request may be rejected.

Loans Secured by Inventory Normally, manufacturers, wholesalers, and retailers have large amounts of money invested in finished goods. In addition, manufacturers carry raw materials and work-in-process inventories. All three types of inventory may be pledged as collateral for short-term loans. However, lenders prefer finished merchandise to raw materials or work-in-process inventories.

A lender may require that inventory used as collateral be stored in a public warehouse. Because of this requirement, this type of financing is sometimes referred to as warehouse financing. In this situation, the receipt issued by the warehouse is retained by the lender. Without this receipt, the public warehouse will not release the merchandise. The lender releases the warehouse receipt—and the merchandise—to the borrower when the borrowed money is repaid. In addition to paying the interest on the loan, the borrower must pay for storage in the public warehouse. As a result, this type of loan is more expensive than an unsecured short-term loan.

Loans Secured by Receivables As defined in Chapter 15, *accounts receivable* are amounts owed to a firm by its customers. A firm can pledge its accounts receivable as collateral to obtain short-term financing. A lender may advance 70 to 80 percent of the dollar amount of the receivables. First, however, it conducts

commercial paper a short-term promissory note issued by a large corporation

Table 16-3 Comparison of Short-Term Financing Methods

Type of Financing	Cost	Repayment Period	Businesses That May Use It	Comments
Trade credit	Low, if any	30–60 days	All businesses with good credit	Usually no finance charge
Promissory note issued to suppliers	Moderate	One year or less	All businesses	Usually unsecured but requires legal document
Unsecured bank loan	Moderate	One year or less	All businesses	Promissory note is required and compensating balance may be required
Commercial paper	Moderate	270 days or less	Large corporations with high credit ratings	Usually available only to large firms
Secured loan	High	One year or less	Firms with questionable credit ratings	Inventory or accounts receivable often used as collateral
Factoring	High	None	Firms that have large numbers of credit customers	Accounts receivable sold to a factor

a thorough investigation to determine the *quality* of the receivables. (The quality of the receivables is the creditworthiness of the firm's customers, coupled with the customers' ability to repay their credit obligations when they are due.) If a favorable determination is made, the loan is approved. Like most business loans, the borrower and the lender negotiate interest rates and repayment terms.

16-5c Factoring Accounts Receivable

Accounts receivable may be used in one other way to help raise short-term financing: They can be sold to a factoring company (or factor). A **factor** is a firm that specializes in buying other firms' accounts receivable. The factor buys the accounts receivable for less than their maturity value; however, it collects the full maturity value when each account matures. The factor's profit is the difference between the maturity value of the accounts receivable and the amount the factor has paid for them. Generally, the amount of profit the factor receives is based on the risk the factor assumes. Risk, in this case, is the probability that the accounts receivable will not be repaid when they mature.

Even though the firm selling its accounts receivable gets less than face value, it does receive needed cash immediately. Moreover, it has shifted both the task of collecting and the risk of nonpayment to the factor, which now owns the accounts receivable. Generally, customers whose accounts receivable have been factored are given instructions to make their payments directly to the factor.

16-5d Cost Comparisons

Table 16-3 compares the various types of short-term financing. As you can see, trade credit is the least expensive. Secured loans and factoring of accounts receivable are typically the highest-cost methods shown.

16-6 Sources of Equity Financing

Sources of long-term financing vary with the size and type of business. As mentioned earlier, a sole proprietorship or partnership acquires equity capital (sometimes referred to as *owners' equity*) when the owner or partners invest money in the business. For corporations, equity-financing options include the sale of stock and the use of profits not distributed to owners. All three types of businesses can also

✓ Concept Check

- How important is trade credit as a source of short-term financing?
- Why would a supplier require a customer to sign a promissory note?
- What is the prime rate? Who gets the prime rate?
- Explain how factoring works. Of what benefit is factoring to a firm that sells its receivables?

factor a firm that specializes in buying other firms' accounts receivable

Learning Objective

16-6 Evaluate the advantages and disadvantages of equity financing.

obtain venture capital and use long-term debt capital (borrowed money) to meet their financial needs.

16-6a **Selling Stock**

Some equity capital is used to start every business—sole proprietorship, partnership, or corporation. In the case of corporations, stockholders who buy shares in the company provide equity capital.

Initial Public Offering and the Primary Market An **initial public offering (IPO)** occurs when a corporation sells common stock to the general public for the first time. McAfee—a corporation known as a leader in protecting consumers, businesses, and governments from cyberattacks—used an IPO to raise $740 million in late 2020. At the time of publication of this text, there are more companies that plan to use IPOs to raise capital as the economy begins to stabilize after the COVID-19 pandemic. As illustrated in Figure 16-6, the largest IPOs for U.S. companies—Visa, Facebook, General Motors, AT&T Wireless, and Kraft Foods—involve companies from a number of different industries.

Established companies that plan to raise capital by selling subsidiaries to the public can also use IPOs. In 2020, global biotech giant GenScript completed an IPO valued at over $400 million by spinning off Legend BioTech—a company that engages in the discovery and development of drug therapies for different kinds of cancer treatments. Monies from the IPO will be used to increase the parent company's cash balance and provide funding for growth and expansion.[11] In addition to using an IPO to increase the cash balance for the parent company, corporations often sell shares in a subsidiary when shares can be sold at a profit or when the subsidiary no longer fits with its current business plan. Finally, some corporations will sell a subsidiary that is growing more slowly than the rest of the company's operating divisions.

When a corporation uses an IPO to raise capital, the stock is sold in the primary market. The **primary market** is a market in which an investor purchases financial securities (via an investment bank) directly from the issuer of the securities. An **investment banking firm** is an organization that assists corporations in raising funds, usually by helping to sell new issues of stocks, bonds, or other financial securities.

Although a corporation can have only one IPO, it can sell additional stock after the IPO, assuming that there is a market for the company's stock. Even though the cost of selling stock (often referred to as *flotation costs*) is high, the *ongoing* costs

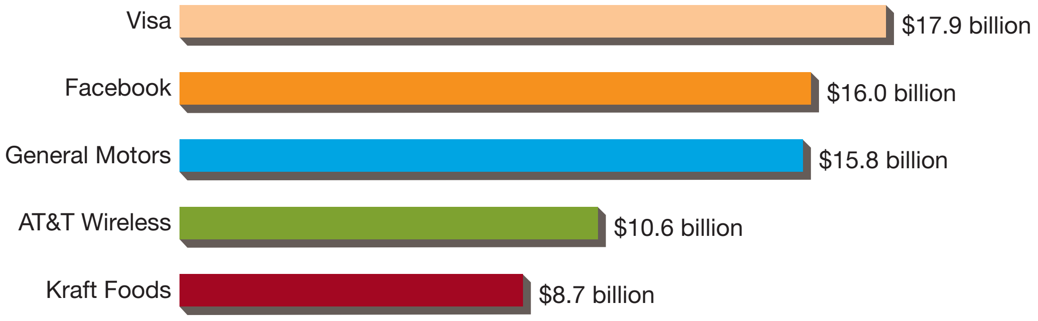
initial public offering (IPO) occurs when a corporation sells common stock to the general public for the first time

primary market a market in which an investor purchases financial securities (via an investment bank) directly from the issuer of those securities

investment banking firm an organization that assists corporations in raising funds, usually by helping to sell new issues of stocks, bonds, or other financial securities

Figure 16-6 **The All-Time Largest Initial Public Offerings for U.S. Companies**

These five U.S. corporations raised billions of dollars by selling stock. Visa—the record holder for companies in the United States—raised $17.9 billion when it sold stock for the first time in 2008.



Source: "All-Time Largest U.S. IPOs," Renaissance Capital, Greenwich, CT, https://www.renaissancecapital.com/IPO-Center/Stats/Largest-US-IPOs (accessed March 5, 2021).

associated with this type of equity financing are low for two reasons. First, the corporation does not have to repay money obtained from the sale of stock because the corporation is under no legal obligation to do so. If you purchase corporate stock and later decide to sell your stock, you may sell it to another investor—not the corporation.

A second advantage of selling stock is that a corporation is under no legal obligation to pay dividends to stockholders. As noted in Chapter 4, a *dividend* is a distribution of earnings to the stockholders of a corporation. For any reason (e.g., if a company has a bad year), the board of directors can vote to omit dividend payments. Earnings then are retained for use in funding business operations. Of course, corporate management may hear from unhappy stockholders if expected dividends are omitted too frequently.

The Secondary Market Although a share of corporate stock is only sold one time in the primary market, the stock can be sold again and again in the secondary market. The **secondary market** is a market for existing financial securities that are traded between investors. Although a corporation does not receive money each time its stock is bought or sold in the secondary market, the ability to obtain cash by selling stock investments is one reason why investors purchase corporate stock. Without the secondary market, investors would not purchase stock in the primary market because there would be no way to sell shares to other investors. Usually, secondary-market transactions are completed through a securities exchange or the over-the-counter (OTC) market.

A **securities exchange** is a marketplace where member brokers meet to buy and sell securities. Generally, securities issued by larger corporations are traded at the New York Stock Exchange (NYSE) or at regional exchanges located in different parts of the country. The securities of very large corporations may be traded at more than one of these exchanges. Securities of firms also may be listed on foreign securities exchanges—in Tokyo or London, for example.

Stocks issued by several thousand companies are traded in the OTC market. The **over-the-counter (OTC) market** is a network of dealers who buy and sell the stocks of corporations that are not listed on a securities exchange. The term *over-the-counter* was coined more than 100 years ago when securities actually were sold "over the counter" in stores and banks. Many stocks are traded through an *electronic* exchange called the Nasdaq (pronounced "nazzdack"). The Nasdaq is now one of the largest securities markets in the world. Today, the Nasdaq is known for its forward-looking, innovative, growth companies, including Intel, Microsoft, Cisco Systems, and Apple Computer.

There are two types of stock: common and preferred. Each type has advantages and drawbacks as a means of long-term financing.

Common Stock A share of **common stock** represents the most basic form of corporate ownership. In return for the financing provided by selling common stock, management must make certain concessions to stockholders that may restrict or change corporate policies. For example, every corporation must hold an annual meeting, at which the holders of common stock may vote for the board of directors. Often, stockholders are also asked to approve or disapprove of major corporate actions.

secondary market a market for existing financial securities that are traded between investors

securities exchange a marketplace where member brokers meet to buy and sell securities

over-the-counter (OTC) market a network of dealers who buy and sell the stocks of corporations that are not listed on a securities exchange

common stock the most basic form of corporate ownership and whose owners may vote on corporate policies

MIHA TRAVNIK/SHUTTERSTOCK.COM

The NYSE: The largest stock exchange in the world. Most investors think of the New York Stock Exchange—often referred to as the NYSE—as the securities exchange where stocks for well-established, stable companies are traded. On the other hand, Nasdaq—the second largest securities market in the world—is where stocks for many innovative and technology companies are traded. The bottom line: Both the NYSE and Nasdaq are necessary components that enable investors to buy and sell stocks.

STEPHEN COBURN/SHUTTERSTOCK.COM

Few investors will buy common stock unless they believe that their investment will increase in value. As already mentioned, stockholders may receive dividends if the corporation's board of directors approves a dividend distribution. Also, stockholders can profit from their investment if a corporate stock increases in value. Additional information on the reasons why investors purchase stocks and how to evaluate stock investments is provided in Online-Only Chapter 17, "Understanding Personal Finances and Investments."

Preferred Stock As noted in Chapter 4, the owners of *preferred stock* must receive their dividends before holders of common stock receive theirs. And, preferred stockholders know the dollar amount of their dividend because it is stated on the stock certificate. When compared to common stockholders, preferred stockholders also have first claim (after creditors) on assets if the corporation is dissolved or declares bankruptcy. Even so, as with common stock, the board of directors must approve dividends on preferred stock, and this type of financing does not represent a debt that must be legally repaid. In return for preferential treatment, preferred stockholders generally give up the right to vote at a corporation's annual meeting.

16-6b Retained Earnings

Most large corporations distribute only a portion of their after-tax earnings to stockholders. The portion of a corporation's profits *not* distributed to stockholders is called **retained earnings**. Because they are undistributed profits, retained earnings are considered a form of equity financing.

The amount of retained earnings in any year is determined by corporate management and approved by the board of directors. Most small or growing corporations pay no cash dividend—or a very small dividend—to their stockholders. All or most earnings are reinvested in the business for research and development, expansion, or the funding of major projects. Reinvestment tends to increase the value of the firm's stock while it provides essentially cost-free financing for the business. More mature corporations may distribute 40 to 60 percent of their after-tax profits as dividends. Utility companies and other corporations with very stable earnings often pay out as much as 80 to 90 percent of what they earn. For a large corporation, retained earnings can amount to a hefty bit of financing. For example, as reported in its last annual report, the total amount of retained earnings for Procter & Gamble was over \$100.2 billion.[12]

16-6c Venture Capital, Angel Investors, and Private Placements

To establish a new business or expand an existing one, an entrepreneur may try to obtain venture capital. In Chapter 5, we defined *venture capital* as money invested in small (and sometimes struggling) firms that have the potential to become very successful. Most venture capital firms do not invest in the typical small business—a neighborhood convenience store or a local dry cleaner—but in firms that have the potential to become extremely profitable. For example, Google, Apple, Facebook, and Uber all received venture capital before they became large, successful companies.

Generally, a venture capital firm consists of a pool of investors, a partnership established by a wealthy family, or corporations with money to invest. In return for financing, these investors generally receive an equity or ownership position in the business and share in its profits. Although venture capital firms are willing to take chances, they have also become more selective about where they invest their money. Often, venture capitalists prefer to invest in companies that have passed the initial start-up phase and show potential for rapid growth, increased sales and profits, and expansion.

retained earnings the portion of a corporation's profits not distributed to stockholders

Another source of capital for a start-up business is an angel investor. An **angel investor** is often a wealthy investor who provides financial backing for small business start-ups or entrepreneurs. Often, an angel investor may be an entrepreneur's family member or a friend that provides the financial support needed to start a business. Unlike venture capitalists, angel investors are often more focused on helping a business or an entrepreneur succeed rather than earning huge profits. Some angel investors even become more involved in the business and become mentors for entrepreneurs to help them grow and expand the business. Angel investors may provide more favorable financial terms when compared with venture capitalists, bankers, and other financial institutions. In return for providing needed financing, angel investors can become an owner with equity in the firm. In other cases, angel investors loan money to a small business much like a bank or other financial institution.

Another method of raising capital is through a private placement. A **private placement** occurs when stock and other corporate securities are sold directly to wealthy investors, banks and financial firms, insurance companies, pension funds, large institutional investors, or mutual funds. When compared with selling stocks and other corporate securities to the public, there are often fewer government regulations and the cost is generally less when the securities are sold through a private placement. Typically, terms between the buyer and seller are negotiated when a private placement is used to raise capital.

angel investor a wealthy investor who provides financial backing for small business start-ups or entrepreneurs

private placement occurs when stock and other corporate securities are sold directly to wealthy investors, banks and financial firms, insurance companies, pension funds, large institutional investors, or mutual funds

✓ Concept Check

- What are the advantages of financing through the sale of stock?
- From a corporation's point of view, how does preferred stock differ from common stock?
- What is venture capital? An angel investor? A private placement?

Entrepreneurial Success

How Can Small Businesses Secure Financing?

To start a small business and keep it running smoothly, owners must provide or obtain money, and there are a variety of financing options for small businesses. Selecting the right type of financing often depends on a variety of factors such as the business's financial needs, the business owner's financial resources, and the owner's willingness to share control of the business.

To start the search for financing, small business owners should determine what the money will be used for and how much money is needed. For example, money is often needed to purchase equipment; retail, manufacturing, or office space; inventory; marketing and advertising; computers and software; web services; and more. When small business owners do not have enough money to purchase the resources needed to open or grow their business, they must look to other sources to secure additional financing.

To retain control of the business, owners can apply for a loan. Applicants are expected to share their business plan, financial projections to demonstrate how much money is needed, how long it will take to repay the loan, and the type of collateral (if any) that will secure the loan. There are many types of loans small business owners can apply for, including business lines of credit, invoice financing available from suppliers, long-term loans, and loans from the Small Business Administration. It is even possible to apply for a microloan, which are offered by nonprofits and mission-based lenders to help small business owners start a business in disadvantaged communities. The most popular microloan source is Kiva (kiva.org).

To avoid involving investors and financial institutions, business owners can also use crowdfunding to raise small amounts of money from many individuals. The most popular sites for crowdfunding are Kickstarter, Indiegogo, and Patreon. Because people that contribute to crowdfunding projects do not receive a share of ownership in the companies they support, they are not considered investors or lenders.

One additional way business owners can secure funding is to seek venture capital. Venture capital is a form of private equity that provides businesses with money in exchange for an ownership share or an active role in the company. It is also considered a form of long-term financing. Venture capitalists typically focus on high-growth companies that have the potential to become extremely profitable. In return for higher returns, they are willing to accept the higher risk often associated with high-growth companies.

Sources: Based on information in U.S. Small Business Administration, "Fund Your Business," March 11, 2021, https://www.sba.gov/funding-programs; Steve Nicastro, "Types of Business Loans: Compare Your Financing Options," *Nerd Wallet*, December 23, 2020, www.nerdwallet.com/article/small-business/types-of-business-loans; Chloe Goodshore, "Best Small-Business Funding Options 2021," December 17, 2020, https://www.business.org/finance/loans/best-small-business-funding-options/.

16-7 Sources of Long-Term Debt Financing

Learning Objective

16-7 Evaluate the advantages and disadvantages of long-term debt financing.

As pointed out earlier in this chapter, businesses borrow money on a short-term basis for many valid reasons other than desperation. There are equally valid reasons for long-term borrowing. In addition to using borrowed money to meet the long-term needs listed in Table 16-1, successful businesses often use the financial leverage it creates to improve their financial performance. **Financial leverage** is the use of borrowed funds to increase the return on owners' equity. To understand how financial leverage can increase a firm's return on owners' equity, study the information for Texas-based Cypress Springs Plastics presented in Table 16-4. Pete Johnston, the owner of the firm, is trying to decide how best to finance a $100,000 purchase of new high-tech manufacturing equipment.

financial leverage the use of borrowed funds to increase the return on owners' equity

- He could borrow $100,000 and pay 7 percent annual interest.
- He could invest an additional $100,000 in the firm.

Assuming that the firm earns $95,000 a year and that annual interest for this loan totals $7,000 ($100,000 × 0.07 = $7,000), the return on owners' equity for Cypress Springs Plastics would be higher if the firm borrowed the additional financing. Return on owners' equity is determined by dividing a firm's profit by the dollar amount of owners' equity. Based on the calculations illustrated in Table 16-4, Cypress Springs Plastics' return on owners' equity equals 17.6 percent if Johnston borrows the additional $100,000. The firm's return on owners' equity would decrease to 15.8 percent if Johnston invests an additional $100,000 in the business.

The most obvious danger when using financial leverage is that the firm's earnings may be lower than expected. If this situation occurs, the fixed interest charge actually works to reduce or eliminate the return on owners' equity. Of course, borrowed money eventually must be repaid.

For a small business, long-term debt financing is generally limited to loans. Large corporations have the additional option of issuing corporate bonds.

16-7a Long-Term Loans

Many businesses satisfy their long-term financing needs, such as those listed in Table 16-1, with loans from banks and other financial institutions. Manufacturers and suppliers of heavy machinery or equipment may also provide long-term debt financing.

Table 16-4 Analysis of the Effect of Additional Capital from Debt or Equity

Additional Debt		Additional Equity	
Owners' equity	$500,000	Owners' equity	$500,000
Additional equity	+0	Additional equity	+100,000
Total owner's equity	$500,000	Total owner's equity	$600,000
Loan (@ 7%)	+100,000	No loan	+0
Total capital	$600,000	Total capital	$600,000
Year-End Earnings			
Gross profit	$95,000	Gross profit	$95,000
Less loan interest	−7,000	No interest	+0
Profit	$88,000	Profit	$95,000
Return on owners' equity	17.6%	Return on owners' equity	15.8%
($88,000 ÷ $500,000 = 17.6%)		($95,000 ÷ $600,000 = 15.8%)	

Term-Loan Agreements A **term-loan agreement** is a promissory note that requires a borrower to repay a loan in monthly, quarterly, semiannual, or annual installments. As discussed earlier in this chapter, repayment may be as long as 15 to 20 years, but long-term business loans normally are repaid in 3 to 7 years. Loans where real estate serves as collateral may be as long as 30 years.

Assume that Pete Johnston, the owner of Cypress Springs Plastics, decides to borrow $100,000 and take advantage of the principle of financial leverage illustrated in Table 16-4. Although the firm's return on owners' equity does increase, interest must be paid each year and, eventually, the loan must be repaid. To pay off a $100,000 loan over a three-year period with annual payments, Cypress Springs Plastics must pay $33,333 on the loan balance plus $7,000 annual interest, or a total of $40,333 the first year. Although the amount of interest decreases each year because of the previous year's payment on the loan balance, annual payments of this amount are still a large commitment for a small firm such as Cypress Springs Plastics.

The interest rate and repayment terms for term loans often are based on factors such as the reasons for borrowing, the borrowing firm's credit rating, and the value of collateral. Although long-term loans occasionally may be unsecured, the lender usually requires some type of collateral. Acceptable collateral includes real estate, stocks, bonds, equipment, or any asset with value. Lenders may also require that borrowers maintain a minimum amount of working capital.

Loan Application
Complete your application

RAWPIXEL.COM/SHUTTERSTOCK.COM

Loan approval 101. Before you ask for a loan, you should get to know your banker (or lender). Make sure your banker understands your business, your future plans, and how the loan will be repaid. Then, you will be asked to complete a loan application and interview with a loan officer or even a loan committee before a decision to approve or reject a loan request is made.

16-7b Corporate Bonds

In addition to loans, large corporations may choose to issue bonds in denominations of $1,000 to $50,000. Although the usual face value for corporate bonds is $1,000, the total face value of all the bonds in an issue usually amounts to millions of dollars. In fact, one of the reasons why corporations issue bonds is because they can sell bonds to a lot of different bondholders and raise larger amounts of money than could be borrowed from one lender. Also, the interest rate for corporate bonds is often lower than the interest rate for a long-term loan from a bank or other financial institution. A **corporate bond** is a corporation's written pledge that it will repay a specified amount of money with interest. Interest rates for corporate bonds vary with the financial health of the company issuing the bond. Specific factors that increase or decrease the interest rate that a corporation must pay when it issues bonds include:

- The corporation's ability to pay interest each year until maturity; and
- The corporation's ability to repay the bond at maturity.

For bond investors, the interest rate on corporate bonds is an example of the risk–return ratio discussed earlier in this chapter. Simply put: Investors expect a higher return when they purchase high-risk, speculative bond issues—refer to Figure 16-7.

Today, most corporate bonds are registered bonds. A **registered bond** is a bond registered in the owner's name by the issuing company. Many corporations do not issue actual bonds. Instead, the bonds are recorded electronically, and the specific details regarding the bond issue, along with the current owner's name and address, are maintained by computer. Computer entries are safer because they cannot be stolen, misplaced, or destroyed, and make it easier to transfer when a bond is sold.

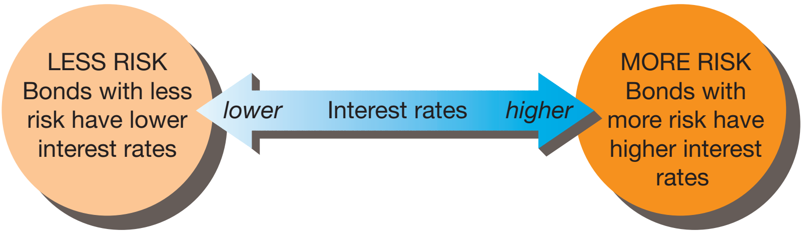
term-loan agreement a promissory note that requires a borrower to repay a loan in monthly, quarterly, semiannual, or annual installments

corporate bond a corporation's written pledge that it will repay a specified amount of money with interest

registered bond a bond registered in the owner's name by the issuing company

Figure 16-7 The Risk–Return Ratio for Corporate Bond Investors

High-quality corporate bonds pay less interest when compared to bonds that are more speculative.


LESS RISK
Bonds with less risk have lower interest rates
lower
Interest rates
higher
MORE RISK
Bonds with more risk have higher interest rates

The **maturity date** is the date on which the corporation is to repay the borrowed money. Until a bond's maturity, a corporation pays interest to the bond owner at the stated rate. For example, owners of Dollar Tree bonds that mature in 2028 receive 4.20 percent interest per year for each bond they own. For each $1,000 bond issued, the corporation must pay bondholders $42 ($1,000 × 0.0420 = $42) each year. Because interest for corporate bonds is usually paid semiannually, the owner of a Dollar Tree bond will receive a $21 payment every six months for each bond they own. On the maturity date, a registered owner will receive cash equaling the face value of the bond.

Types of Bonds Corporate bonds are generally classified as debentures, mortgage bonds, or convertible bonds. Most corporate bonds are debenture bonds. A **debenture bond** is a bond backed only by the reputation of the issuing corporation. To make its bonds more appealing to investors, a corporation may issue mortgage bonds. A **mortgage bond** is a corporate bond secured by various assets of the issuing firm. The corporation can also issue convertible bonds. A **convertible bond** can be exchanged, at the owner's option, for a specified number of shares of the corporation's common stock. For example, Southwest Airlines—a passenger airline that provides scheduled flights in both the United States and nearby international locations—has issued convertible bonds that mature in 2025. Each bond can be converted to 25.9909 shares of Southwest Airlines common stock, which means investors could convert each $1,000 bond if the price of a share of the stock increases to $38.48 ($1,000 ÷ 25.9909 = $38.48) a share or higher. A corporation can gain in three ways by issuing convertible bonds. First, convertibles usually carry a lower interest rate than nonconvertible bonds. Second, the conversion feature attracts investors who are interested in the speculative gain that conversion to common stock may provide. Third, if the bondholder converts to common stock, the corporation no longer has to redeem the bond at maturity.

Repayment Provisions for Corporate Bonds Maturity dates for bonds generally range from one to 30 years after the date of issue. Some bonds are callable before the maturity date; that is, a corporation can buy back, or redeem, them. For these bonds, the corporation may pay the bond owner a call premium. The amount of the call premium, if any, is specified, along with other provisions, in the bond indenture. The **bond indenture** is a legal document that details all the conditions relating to a bond issue.

A corporation may use one of three methods to ensure that it has sufficient funds available to redeem a bond issue. First, it can issue the bonds as **serial bonds**, which are bonds of a single issue that mature on different dates. Second, the corporation can establish a sinking fund. A **sinking fund** is a sum of money to which deposits are made each year for the purpose of redeeming a bond issue. When Union Pacific Corporation sold a $275 million bond issue, the company agreed to contribute to a sinking fund until the bond's maturity in the year 2025. Third, a corporation can pay off an old bond issue by selling new bonds.

A corporation that issues bonds must also appoint a **trustee**, an individual or an independent firm that acts as the bond owners' representative. A trustee's duties

maturity date the date on which a corporation is to repay borrowed money

debenture bond a bond backed only by the reputation of the issuing corporation

mortgage bond a corporate bond secured by various assets of the issuing firm

convertible bond a bond that can be exchanged, at the owner's option, for a specified number of shares of the corporation's common stock

bond indenture a legal document that details all the conditions relating to a bond issue

serial bonds bonds of a single issue that mature on different dates

sinking fund a sum of money to which deposits are made each year for the purpose of redeeming a bond issue

trustee an individual or an independent firm that acts as the bond owners' representative

Table 16-5 Comparison of Long-Term Financing Methods

Type of Financing	Repayment	Repayment Period	Cost/Dividends/Interest	Businesses That May Use It
Equity				
Common stock	No	None	High initial cost; low ongoing costs because dividends not required	All corporations that sell stock to investors
Preferred stock	No	None	Dividends not required but must be paid before common stockholders receive any dividends	Large corporations that have an established investor base of common stockholders
Debt				
Long-term loan	Yes	Usually 3–7 years	Interest rates between 3 and 12 percent depending on economic conditions, the financial stability of the company requesting the loan, and the amount of the loan	All firms that can meet the lender's repayment and collateral requirements
Corporate bond	Yes	Usually 1–30 years	Interest rates between 1.25 and 8 percent depending on the financial stability of the company issuing the bonds and economic conditions	Large corporations that are financially healthy

are handled most often by a commercial bank or other large financial institution. The corporation must report to the trustee periodically regarding its ability to make interest payments and eventually redeem the bonds at maturity. In turn, the trustee transmits this information to the bond owners, along with its own evaluation of the corporation's ability to pay.

16-7c **Cost Comparisons**

Table 16-5 compares some of the methods that can be used to obtain long-term equity *and* debt financing. Although the initial flotation cost of issuing stock is high, selling common stock is generally a popular option for most financial managers. Once the stock is sold and upfront, flotation costs are paid, the *ongoing* costs of using stock to finance a business are low. The type of long-term financing that generally has the highest *ongoing* costs is a long-term loan (debt).

To a great extent, businesses are financed through the investments of individuals—money that people have deposited in banks or have used to purchase stocks, mutual funds, and bonds. In the Online-Only Chapter 17, "Understanding Personal Finances and Investments," we look at how you can improve your personal finances and invest your money in business.

✓ Concept Check

- Describe how financial leverage can increase return on owners' equity.
- For a corporation, what are the advantages of corporate bonds over long-term loans?
- What is a debenture? A mortgage bond? A convertible bond?
- Describe the three methods used to ensure that funds are available to redeem corporate bonds at maturity.

Summary

16-1 Explain why financial management is important in today's competitive economy.

Financial management consists of all the activities concerned with obtaining money and using it effectively. For a business, the activities they can undertake are determined by the types of financing available. Financial managers must also ensure that funds are obtained at the lowest possible cost, and that they are used as efficiently as possible. The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law to stabilize the economy, improve oversight of the financial industry, and protect consumers. And today, there is an ongoing debate if more regulations are needed. Still, there are a number of rewarding jobs in finance for qualified job applicants.

16-2 Identify a firm's short- and long-term financial needs.

Short-term financing is money that will be used for one year or less. There are many short-term needs, but cash flow, speculative production, and inventory are three for which financing is often required. Long-term financing is money that will be used for more than one year. Such financing may be required for a business start-up, for a merger or an acquisition, for new product development, for long-term marketing activities, for replacement of equipment, or for expansion of facilities. According to financial experts, business firms will find it more difficult to raise both short- and long-term financing in the future because of increased regulations and more cautious lenders. Financial managers must also consider the risk–return ratio when making financial decisions.

16-3 Summarize the process of planning for financial management.

A financial plan begins with an organization's goals and objectives. Next, a firm's goals and objectives are "translated" into departmental budgets that detail expected income and expenses. From these budgets, which may be combined into an overall cash budget, the financial manager determines what funding will be needed. The four principal sources of financing are sales revenues, equity capital, debt capital, and proceeds from the sale of assets. Whereas departmental and cash budgets emphasize short-term financing needs, a capital budget can be used to estimate a firm's expenditures for major assets and its long-term financing needs. Once the needed funds have been obtained, the financial manager is responsible for monitoring and evaluating the firm's financial activities.

16-4 Identify the services provided by banks and financial institutions for their business customers.

Banks and other financial institutions offer today's business customers an array of services. Among the most important banking services are savings accounts and certificates of deposit, checking accounts, short- and long-term loans, and debit card and credit card processing. Increased use of electronic funds transfer systems (automated teller machines, automated clearinghouse systems, point-of-sale terminals, and electronic check conversion) also will change the way that business firms bank and conduct typical business transactions. For firms in the global marketplace, a bank can provide letters of credit and banker's acceptances that will reduce the risk of nonpayment for sellers. Banks and financial institutions also can provide currency exchange to reduce payment problems for import or export transactions.

16-5 Describe the advantages and disadvantages of different methods of short-term debt financing.

Most short-term financing is unsecured; that is, no collateral is required. Sources of unsecured short-term financing include trade credit, promissory notes issued to suppliers, unsecured bank loans, and commercial paper. Sources of secured short-term financing include loans secured by inventory and accounts receivable. A firm may also sell its receivables to factors. Trade credit is the least expensive source of short-term financing. The cost of financing through other sources generally depends on the source and on the credit rating of the firm that requires the financing. Factoring is generally the most expensive approach.

16-6 Evaluate the advantages and disadvantages of equity financing.

The first time a corporation sells stock to the general public is referred to as an initial public offering (IPO). With an IPO, the stock is sold in the primary market. Once sold in the primary market, investors buy and sell stock in the secondary market. Usually, secondary market transactions are completed through a securities exchange or the over-the-counter market. Common stock is voting stock; holders of common stock elect the corporation's directors and often must approve major corporate actions. Holders of preferred stock must be paid dividends before holders of common stock are paid any dividends. Another source of equity funding is retained earnings, which is the portion of a business's profits *not* distributed to stockholders. Venture capital—money invested in small (and sometimes struggling) firms that have the potential to become very successful—is yet another source of equity funding. Angel investors can also provide the money needed to start or expand small businesses. Finally, a private placement can be used to sell stocks and other corporate securities.

16-7 Evaluate the advantages and disadvantages of long-term debt financing.

For a small business, debt financing is generally limited to loans. Large corporations have the additional option of issuing corporate bonds. Regardless of whether the business is small or large, it can take advantage of financial leverage. Financial leverage is the use of borrowed funds to increase the return on owners' equity. The rate of interest for long-term loans usually depends on the financial strength of the borrower, the reason for borrowing, and the kind of collateral pledged to back up the loan. Long-term business loans are normally repaid in 3 to 7 years. Money realized from the sale of corporate bonds must be repaid when the bonds mature. In addition, the corporation must pay interest from the time the bonds are issued until maturity. Maturity dates for bonds generally range from one to 30 years after the date of issue. Three types of bonds—debentures, mortgage bonds, and convertible bonds—are sold to raise debt capital. When comparing the cost of long-term financing, the ongoing costs of using stock (equity) to finance a business are low. The most expensive is a long-term loan (debt).

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

financial management (468)
short-term financing (470)
cash flow (470)
speculative production (470)
long-term financing (471)
risk–return ratio (472)
financial plan (472)
budget (473)
cash budget (473)
zero-base budgeting (474)
capital budget (474)
equity capital (475)
debt capital (475)
certificate of deposit (CD) (475)
line of credit (476)
revolving credit agreement (476)
collateral (476)
debit card (477)
mobile payment (478)
electronic funds transfer (EFT) system (478)
letter of credit (479)
banker's acceptance (479)
unsecured financing (480)
trade credit (480)
promissory note (481)
prime interest rate (481)
commercial paper (482)
factor (483)
initial public offering (IPO) (484)
primary market (484)
investment banking firm (484)
secondary market (485)
securities exchange (485)
over-the-counter (OTC) market (485)
common stock (485)
retained earnings (486)
angel investor (487)
private placement (487)
financial leverage (488)
term-loan agreement (489)
corporate bond (489)
registered bond (489)
maturity date (490)
debenture bond (490)
mortgage bond (490)
convertible bond (490)
bond indenture (490)
serial bonds (490)
sinking fund (490)
trustee (490)

Discussion Questions

1. Many small business owners find it is difficult to obtain debt financing. What can small business owners do to improve their chances of getting a loan from a bank or other financial institutions?
2. If you were the financial manager of Stars and Stripes Clothing, what would you do with the excess cash that the firm expects in the second, third, and fourth quarters? (Refer to Figure 16-4.)
3. Develop a *personal* cash budget for the next six months. Explain what you would do if there are budget shortfalls or excess cash amounts at the end of any month during the six-month period.
4. Why would a lender offer unsecured short-term loans when it could demand collateral?
5. How can a business owner or corporate manager use financial leverage to improve the firm's profits and return on owners' equity? Is there a potential danger of using financial leverage?
6. In what circumstances might a large corporation sell stock rather than bonds to obtain long-term financing? In what circumstances would it sell bonds rather than stock?

Case 16

DoorDash Delivers An IPO

After its initial public offering (IPO), DoorDash started trading publicly on the New York Stock Exchange (NYSE) in December 2020. An IPO occurs when a corporation sells stock to the general public for the first time. The DoorDash IPO raised over $3 billion when investors purchased its stock on the first day of trading. Notable investors in DoorDash include SoftBank and venture capital firms CRV and Kleiner Perkins. SoftBank, which is known for investing in ByteDance, Fanatics, and Slack, is now the largest shareholder in DoorDash with a 20 percent ownership share after the IPO. The money from this IPO could be used to pay down corporate debt, expansion of services, or any legal business expense.

DoorDash offered three different classes of stock. While all three classes of stock are the same as far as profit distributions are concerned, they have different voting rights. Class A has one vote per share, Class B has 20 votes, and Class C has no voting rights. Offering multiple classes of stock that give different voting rights to different groups of investors has become a common practice in Silicon Valley. As a result of a voting agreement between co-founders Tony Xu, Andy Fang, and Stanley Tang, Xu, who is the company's CEO, will have significant influence over actions requiring the approval of DoorDash's stockholders. These actions, for example, can include electing individuals to the board of directors, making changes to the corporate charter, and approving mergers or acquisitions.

Because of a potential increase in its user base and encouraging projections for future revenues and profits, investors were anxious to purchase shares in DoorDash's IPO. To understand the "why" behind the investor frenzy to get DoorDash stock, it helps to look at how the delivery company earns revenue. A substantial amount of its revenue comes from fees paid by customers and commissions and fees charged to merchants—usually restaurants and grocery stores—for orders completed through the DoorDash marketplace. In addition, the company's DashPass program, which costs a flat monthly delivery fee of $9.99, also generates revenue for DoorDash.

Another factor that encouraged investors was the effect of the COVID-19 pandemic on revenues for food delivery services. DoorDash, which is the leading food delivery app with a 50 percent market share and more than 18 million customers, benefited from an uptick in deliveries during the pandemic. Even after the temporary shelter-in-place orders were lifted, the surge in demand for food delivery continued. DoorDash quickly surpassed its competitors Uber Eats and Grubhub to become the number one food delivery service. To strengthen its position in the industry, DoorDash acquired on-demand food delivery and catering business Caviar in a deal worth $410 million. While these facts are good news for investors, DoorDash has warned that it may not be able to grow at the same pace that it did during the pandemic.

For investors, risk factors include DoorDash's ability to continue to grow and compete, avoid interruptions in services, and attract and retain dashers (delivery workers). In fact, many experts believe that DoorDash's success depends on the success of the restaurant industry. As a result of the pandemic, a significant percentage of restaurants have closed. At the same time, the availability of food delivery services like DoorDash has given rise to restaurateurs that don't have brick-and-mortar locations. Once food is prepared by the restaurateur in a "ghost kitchen," it is picked up by a food delivery service and is delivered to the consumer.

Over the long-term, DoorDash's growth may also slow as more individuals venture back into dine-in restaurants. Additionally, there is intense competition in the food delivery service. And to make matters worse, there is little differentiation between the big players in food delivery. It's very easy for consumers to switch between food delivery providers, and there is very little brand loyalty. In fact, most people have several food delivery apps downloaded to their phone and will compare prices, merchant selections, and promotions before placing their orders.

Another challenge DoorDash faces is keeping its dashers happy. Like the customers who use food delivery services, there is little loyalty among delivery workers. DoorDash operates in an industry where independent contractors (dashers) provide on-demand services for the company's clients. To maintain an adequate supply of dashers, DoorDash must provide its independent contractors with flexibility, compelling opportunities to earn money, and other incentive programs that meet or exceed those of its competitors.

Despite these challenges, DoorDash is confident that it can become a profitable company. The company continues to innovate and identify trends in the rapidly changing food delivery industry. For example, DoorDash has focused on growing its business in suburban areas, which typically have larger ticket totals and lower costs. So far, the company's strategies have paid off because it now controls a 58 percent market share in suburban areas.

Even though it currently is the recognized leader in the food delivery industry and is experiencing growth in both revenues and its user base, DoorDash will have to continue to innovate to maintain its healthy market share in order to earn a profit for its investors. Like many corporations that use an IPO to raise money, DoorDash can expect that the next few years will be interesting for both management and investors.[13]

Questions

1. For a company like DoorDash, what are the advantages and disadvantages of using an IPO to raise capital?
2. Why do you think DoorDash issued three different classes of stock with different voting rights for each class of stock? As an investor, how important is the right to vote on issues that affect the future of the corporation?
3. Although DoorDash currently has 50 percent of the market for food delivery services and more than 18 million users, it must continue to increase both its number of users and its revenues. What are the challenges and obstacles that could affect DoorDash's plans for future growth?

Building Skills for Career Success

1. Social Media Exercise

One of the best-known sites for help managing your finances is Mint. The main reasons people like Mint is that it provides an easy way to track spending, create budgets, and monitor cash flow. Another reason for Mint's popularity is the company's use of social media through its YouTube informative videos.

1. Examine the information on Mint's website at mint.com. Then view some of the videos provided by Mint on YouTube (https://www.youtube.com/mint). Do you think Mint's videos on YouTube could help you make better financial decisions?
2. Although Mint is primarily designed for individuals, could the information on the Mint website and its videos on YouTube help small business owners improve their financial management?
3. Can you think of other companies that could use videos on a YouTube channel to share information that their customers could use?

2. Building Team Skills

Suppose that for the past three years you have been repairing lawn mowers in your garage. Your business has grown steadily and you recently hired two part-time workers. Your garage is no longer adequate for your business; it is also in violation of the city code, and you have already been fined for noncompliance. You have decided that it is time to find another location for your shop and that it also would be a good time to expand your business. If the business continues to grow in the new location, you plan to hire a full-time employee to repair small appliances. You are concerned, however, about how you will get the money to move your shop and get it established in a new location.

Assignment

1. With all class members participating, use brainstorming to identify the following:
   a. The funds you will need to accomplish your business goals
   b. The sources of short-term financing available to you
   c. Problems that might prevent you from getting a short-term loan
   d. How you will repay the money if you get a loan
2. Have a classmate write the ideas on the board.
3. Discuss how you can overcome any problems that might hamper your current chances of getting a loan and how your business can improve its chances of securing short-term loans in the future.
4. Summarize what you learned from participating in this exercise.

3. Researching Different Careers

Financial managers are responsible for determining the best way to raise funds at the lowest possible cost, for ensuring that the funds are used to accomplish their firm's goals and objectives, and for developing and implementing their firm's financial plan. Their decisions have a direct impact on the firm's level of success and if the firm is profitable or not.

Assignment

1. Investigate the job of financial manager by searching for information available in the library or on the internet or by interviewing a financial manager.
2. Find answers to the following questions:
   a. What skills do financial managers need?
   b. How much education is required?
   c. What is the starting salary? Top salary?
   d. What will the job of financial manager be like in the future?
   e. What opportunities are available?
   f. What types of firms are most likely to hire financial managers? What is the employment potential?
3. Prepare a report on your findings.

Running a Business

Part 6

Graeter's Recipe for Growth: New Systems, Social Media, and Financing

Graeter's still makes ice cream by hand, just like the founders did in 1870. But in every other respect, it's a very different business from the mom-and-pop firm founded by the great-grandparents of Richard, Robert, and Chip Graeter. For example, Graeter's now uses social media to stay in touch with customers and see what people say about its brand. Technology is also a factor in the new information systems Graeter's recently installed to keep the business running smoothly as it pursues fast-paced growth and expansion in new markets and in national supermarket chains across the United States. Just as important, the company has arranged financing to support its long-term plans for national expansion.

Graeter's Social Side

Even a small business can have a big presence in social media, including Facebook, Twitter, YouTube, and Pinterest. With more than 210,000 "likes," Graeter's provides information about the company, reviews from customers, schedules for special events, information about where its four food trucks will be located on specific dates, and more on its Facebook page. It also posts a new message or photo every few days, and reveals the names of mystery flavors on Facebook in advance of other publicity. As a result, fans return to its Facebook page often. In addition, Graeter's tweets frequently and periodically posts videos on its YouTube channel. There are even hundreds of photos of Graeter's ice cream and bakery products posted on the Pinterest site. Graeter's also monitors "mentions" of its brand on other social-media sites. As other people add their comments and click to "like," the conversation continues and the word of mouth builds buzz for Graeter's.

New Growth, New Systems

Paul Porcino, a consultant working with the Graeter family, observes that small, entrepreneurial firms often have only "a very small amount of information, and ... it hasn't been pulled together in any meaningful way." The first step was to define what Graeter's executives needed to know to run the business. For example, they needed to be able to track unit sales online, in each store, and to each wholesale customer, and to measure both costs and profitability by product and distribution channel.

Despite some technical challenges during implementation, Graeter's has already experienced some of the benefits of collecting better information. When management noticed that overall bakery sales weren't up to par, "we had to adjust," comments Porcino. The remedy was surprising: "We actually reduced the number of products we were selling in the store. . . It wasn't very clear exactly how much we were selling, but at least [we had] the good-enough gut sense in terms of the ones that were not selling, and we . . . adjusted the total inventory line."

Counting on Accounting

Graeter's controller, David Blink, is responsible for preparing "all financial statements, all reports, payroll, [and] any ad hoc reports that any of the managers would need. I handle a lot of the reporting for the retail side as well as the manufacturing side," he says. With these reports in hand, the Graeter's team can make informed decisions about how many seasonal employees to hire, which products to keep, how much to invest in new equipment, and other issues that arise day by day. Although an outside payroll company actually prints the employees' checks, Blink's department collects and analyzes payroll data as input for management decisions. In addition, an outside accounting firm prepares financial statements and additional reports based on information supplied by Blink.

Money Matters

A number of years ago, the Graeter's team recognized they needed a new production facility. After examining what the business had done in the past and where it was going in the future, the three great-grandsons of Graeter's founders constructed a plan to obtain the financing needed to purchase the land and build an additional plant. After scouting possible locations, Graeter's signed a contract with Cincinnati, paying a token amount for land and borrowing $10 million from the city to pay for construction of a new 28,000-square-foot factory. The loan carried low interest rates and would be repaid over 20 years. In exchange, Graeter's committed to "stay and grow" in Cincinnati for at least 20 years, creating dozens of new jobs when the production facility opened and additional jobs as Graeter's growth continued. Now Graeter's has the right combination of ingredients for expanding from coast to coast and beyond.[14]

Questions

1. Suppose you were writing a social media plan for Graeter's, with two objectives: to improve brand awareness in new markets and to build e-commerce sales.
   a. What actions would be included in your plan?
   b. What quantitative and qualitative measurements would you use to evaluate the results of your plan?
2. Graeter's uses information to track cash, sales revenues, expenses, and inventory. How does this type of accounting and financial information facilitate effective decision making?
3. What kinds of questions do you think Cincinnati officials asked Graeter's owners before agreeing to loan the company $10 million? Why would Graeter's go with this financing arrangement rather than borrowing from a bank to pay for the new factory?

Building a Business Plan

Part 6

Now that you have a marketing plan, the next big and important step is to prepare an information and financial plan. One of the biggest mistakes an entrepreneur makes when faced with a need for financing is not being prepared. The information contained in Chapter 14 (Exploring Social Media and e-Business), Chapter 15 (Using Management and Accounting Information), and Chapter 16 (Mastering Financial Management) will help you prepare this section of the business plan and determine the amount of financing you need to start your business. With the help of information in the last three chapters of the text, the task may be easier than you think.

In this last section, you should also provide some information about your exit strategy, and discuss any potential trends, problems, or risks that you may encounter. Now is also the time to go back and prepare the executive summary, which should be placed at the beginning of the business plan.

The Information and Accounting Plan Component

Information and accounting systems are important if your business is to succeed. Your information and accounting plan should answer at least the following questions:

6.1. How will you gather information about competitors, their products, and the prices that they charge for their products and services?

6.2. Explain how you will develop a management information system to collect, store, update, process data, and present information.

6.3. Will your business have an e-commerce component? If so, explain how you sell your products or services online.

6.4. Are there ways that you can use social media to promote products and services and reach out to your customers?

6.5. Who will create and maintain the accounting system that you use to record routine business transactions for your business?

6.6. Will you hire an accountant to prepare financial statements and tax returns for your firm?

The Financial Plan Component

Your financial plan should answer at least the following questions about the investment needed, sales and cash-flow forecasts, breakeven analysis, and sources of funding:

6.7. What is the actual amount of money you need to open your business (start-up budget) and the amount needed to keep it open (operating budget)? Prepare a realistic budget.

6.8. How much money do you have, and can you obtain additional financing, if needed, from investors or lenders?

6.9. Prepare a projected income statement by month for the first year of operation and by quarter for the second and third years.

6.10. Prepare projected balance sheets for each of the first three years of operation.

6.11. Prepare a breakeven analysis. How many units of your products or service will have to be sold to cover your costs?

6.12. Reinforce your final projections by comparing them with industry averages for your chosen industry.

The Exit Strategy Component

Your exit strategy component should at least include answers to the following questions:

6.13. How do you intend to get yourself (and your money) out of the business?

6.14. Will your children take over the business, or do you intend to sell it later?

6.15. Do you intend to grow the business to the point of an IPO?

6.16. How will investors get their money back?

The Critical Risks and Assumptions Component

Your critical risks and assumptions component should answer at least the following questions:

6.17. What will you do if your market does not develop as quickly as you predicted? What if your market develops too quickly?

6.18. What will you do if your competitors underprice or make your product obsolete?

6.19. What will you do if there is an unfavorable industry-wide trend?

6.20. What will happen if trained workers are not available as predicted?

6.21. What will you do if there is an erratic supply of products or raw materials?

The Appendix Component

Supplemental information and documents often are included in an appendix. Here are a few examples of some documents that can be included:

- Résumés of owners and principal managers
- Advertising samples and brochures
- An organization chart
- Floor plans for your retail showroom, office, and storage areas

Review of Business Plan Activities

As you have discovered, writing a business plan involves a long series of interrelated steps. As with any project involving a number of complex steps and calculations, your business plan should be reviewed carefully and revised before you present it to potential investors.

Remember, there is one more component you need to prepare after your business plan is completed: The executive summary should be written last, but because of its importance, it appears after the introduction.

The Executive Summary Component

In the executive summary, give a one- to two-page overview of your entire business plan. This is the most important part of the business plan and is of special interest to busy bankers, investors, and other interested parties. Remember, this section is a summary; more detailed information is provided in the remainder of your business plan.

Make sure that the executive summary captures the reader's attention instantly in the first sentence by using a key selling point or benefit of the business.

Your executive summary should include answers to at least the following:

6.22. *Company information.* What product or service do you provide? What is your competitive advantage? When will the company be formed? What are your company objectives? What is the background of you and your management team?

6.23. *Market opportunity.* What is the expected size and growth rate of your market, your expected market share, and any relevant market trends?

Once again, review your answers to all the questions in the preceding parts to make sure that they are all consistent throughout the entire business plan.

Although many would-be entrepreneurs are excited about the prospects of opening their own business, remember that it takes a lot of hard work, time, and in most cases a substantial amount of money. While the business plan provides an enormous amount of information about your business, it is only the first step. Once it is completed, it is now your responsibility to implement the plan. Good luck in your business venture.

Endnotes

Chapter 1

1 Based on information in “Tesla Overtakes Toyota to Become World’s Most Valuable Carmaker,” *BBC*, July 1, 2020, www.bbc.com/news/business-53257933; James Morris, “How Did Tesla Become the Most Valuable Car Company in the World?” *Forbes*, June 14, 2020, www.forbes.com/sites/jamesmorris/2020/06/14/how-did-tesla-become-the-most-valuable-car-company-in-the-world; Karen Langley, “Tesla Is Now the Most Valuable U.S. Car Maker of All Time,” *The Wall Street Journal*, January 7, 2020, https://www.wsj.com/articles/tesla-is-now-the-most-valuable-u-s-car-maker-of-all-time-11578427858.

2 The Horatio Alger website at www.horatioalger.org (accessed January 10, 2021).

3 Ibid.

4 Greg Kumparak, “A Brief History of Oculus,” the Tech Crunch website at https://techcrunch.com/2014/03/26/a-brief-history-of-oculus/ (accessed January 2, 2021).

5 Julie Stav, “How to Invest in the Stock Market,” the YouTube website, at https://www.youtube.com/watch?v=3zJ4kLQy-Fs (accessed January 4, 2021).

6 The General Mills website at www.generalmills.com (accessed January 2, 2021).

7 The Bureau of Economic Analysis website at www.bea.gov (accessed January 4, 2021).

8 The Bureau of Economic Analysis website at www.bea.gov (accessed January 28, 2021).

9 The Bureau of Labor Statistics website at www.bls.gov (accessed January 8, 2021).

10 The Bureau of Economic Analysis website at www.bea.gov (accessed January 28, 2021).

11 The U.S. Debt Clock website at www.usdebtclock.org (accessed January 8, 2021).

12 The National Bureau of Economic Research website at www.nber.org/research/data/us-business-cycle-expansions-and-contractions (accessed January 8, 2021).

13 “Distribution of the Workforce Across Economic Sectors in the United States from 2010 to 2020,” The Statista website at www.statista.com/statistics/270072/distribution-of-the-workforce-across-economic-sectors-in-the-united-states/ (accessed January 8, 2021).

14 The Environmental Protection Agency website at www.epa.gov (accessed January 4, 2021).

15 Based on information in Company Man, “Zoom - Why They’re Successful,” *YouTube*, June 17, 2020, www.youtube.com/watch?v=s_AjEjiiA9w; Alex Konrad, “Zoom, Zoom, Zoom! The Exclusive Inside Story Of The New Billionaire Behind Tech’s Hottest IPO,” *Forbes*, April 19, 2019, www.forbes.com/sites/alexkonrad/2019/04/19/zoom-zoom-zoom-the-exclusive-inside-story-of-the-new-billionaire-behind-techs-hottest-ipo; Rich Karlgaard, “Why Zoom Is Booming,” *Forbes*, September 16, 2020, www.forbes.com/sites/richkarlgaard/2020/09/16/why-zoom-is-booming; Samantha Murphy Kelly, “Zoom’s Massive ‘Overnight Success’ Actually Took Nine Years,” *CNN*, March 27, 2020, www.cnn.com/2020/03/27/tech/zoom-app-coronavirus/index.html.

Chapter 2

1 Based on information in Sara Randazzo, “Purdue Pharma Reaches $8.34 Billion Settlement Over Opioid Probes,” *The Wall Street Journal*, October 21, 2020, www.wsj.com/articles/purdue-pharma-reaches-8-34-billion-settlement-over-opioid-probes-11603292613; German Lopez, “Purdue Pharma Admits to Crimes for Its OxyContin Marketing. But No One Is Going to Prison,” *Vox*, October 21, 2020, www.vox.com/2020/10/21/21526868/purdue-pharma-oxycontin-opioid-epidemic-department-of-justice; Austin Frakt, “Damage From OxyContin Continues to Be Revealed,” *The New York Times*, April 13, 2020, www.nytimes.com/2020/04/13/upshot/opioids-oxycontin-purdue-pharma.html; Purdue Pharma, “Purpose Statement and Values,” www.purduepharma.com/about/ethics-and-compliance/purpose-statement-values/.

2 Gwen Aviles, “Kendall Jenner to Pay $90,000 Settlement for Promoting Fyre Festival,” *NBCNews,* May 21, 2020, https://www.nbcnews.com/pop-culture/pop-culture-news/kendall-jenner-pay-90-000-settlement-promoting-fyre-festival-n1212011 (accessed December 15, 2020); Evan Comen and Thomas C. Frohlich, “The Biggest Corporate Scandals of the Decade,” *247wallst.com,* December 20, 2019, https://247wallst.com/special-report/2019/12/20/the-biggest-corporate-scandals-of-the-decade/3/ (accessed December 15, 2020).

3 Ben Popken, “Chick-fil-A Sues Chicken Producers Alleging Price Fixing on Billions of Dollars of Poultry,” *NBC News,* December 7, 2020, https://www.nbcnews.com/business/business-news/chick-fil-sues-chicken-producers-alleging-price-fixing-billions-dollars-n1250253 (accessed December 22, 2020).

4 “Marketers of Pain Relief Device Settle FTC False Advertising Complaint,” press release, U.S. Federal Trade Commission, March 4, 2020, https://www.ftc.gov/news-events/press-releases/2020/03/marketers-pain-relief-device-settle-ftc-false-advertising (accessed December 16, 2020).

5 Chris Isadore and Matt Egan, “Robinhood Agrees to Pay a $65 Million Fine for Deceiving Clients,” *CNN,* December 17, 2020, https://www.cnn.com/2020/12/17/investing/robinhood-sec-settlement-deceptive-practices/index.html (accessed December 17, 2020).

6 Shereen Siewart, “Wausau Woman Sentenced in $700k Embezzlement Case,” *Wausau Pilot & Review,* July 29, 2020, https://wausaupilotandreview.com/2020/07/29/wausau-woman-sentenced-in-700k-embezzlement-case/ (accessed January 21, 2021).

7 Chris Prentice, “Wels Fargo to Pay $3 Billion to U.S., Admits Pressuring Workers in Fake-Account Scandal,” *Reuters,* February 21, 2020, https://www.reuters.com/article/us-wells-fargo-scandal-deal/wells-fargo-to-pay-3-billion-to-u-s-admits-pressuring-workers-in-fake-accounts-scandal-idUSKBN20F2KN (accessed December 17, 2020).

8 Ethics Compliance Initiative, “2020 Report: Global Business Ethics Survey,” p. 6, https://www.ethics.org/wp-content/uploads/Global-Business-Ethics-Survey-2020-Report-1-Final.pdf (accessed December 22, 2020).

9 Jonathan Martin, “Plagiarism Costs Degree for Senator John Walsh,” *The New York Times,* October 10, 2014, http://www.nytimes.com/2014/10/11/us/politics/plagiarism-costs-degree-for-senator-john-walsh.html?_r=0 (accessed December 16, 2020).

10 Rob Golum, “Electronic Arts Investors Reject Executive Pay in Rare Rebuke,” Bloomberg News, August 7, 2020, https://www.bloomberg.com/news/articles/2020-08-07/electronic-arts-shareholders-reject-executive-compensation-plan (accessed December 16, 2020); Stan Choe, “CEO Pay: When Investors Give Thumbs-Down to Soaring Compensation Packages,” *Chicago Tribune,* May 24, 2019, https://www.chicagotribune.com/business/ct-biz-ceo-pay-shareholders-get-say-20190524-story.html (accessed December 16, 2020).

11 Marshall Cohen, “Financial Disclosures Reveal Postmaster General’s Business Entanglements and Likely Conflicts of Interest, Experts Say,” *CNN,* August 12, 2020, (accessed December 17, 2020); Allison Durkee, “Louis DeJoy Forced to Divest from Former Company that Contracts with Postal Service,” *Forbes,* October 15, 2020, https://www.forbes.com/sites/alisondurkee/2020/10/15/louis-dejoy-forced-to-divest-from-xpo-logistics-former-company-postal-service-contractor/?sh=2226687f17be (accessed December 17, 2020).

12 Dylan Tokar, “Herbalife Settles US Allegations of Bribery into China,” *The Wall Street Journal,* August 29, 2020, p. B3.

13 Procter & Gamble Company, *Our Worldwide Business Conduct Manual,* p. 51, https://us.pg.com/policies-and-practices/worldwide-business-conduct-manual/ (accessed December 17, 2020).

14 “False Advertising Consumer Class Actions Related to Coffee Servings Continue with Suit Against Folgers,” *The National Law Review,* December 4, 2020, https://www.natlawreview.com/article/false-advertising-consumer-class-actions-related-to-coffee-servings-continue-suit (accessed December 18, 2020).

15 Jared Bryant, Amanda J. Beane, and Jason Howell, “$1 Million Settlement Announced in FTC’s ‘Made in USA’ Enforcement Against Williams-Sonoma,” *Consumer Protection Review,* April 24, 2020, https://www.consumerprotectionreview.com/2020/04/1-million-settlement-announced-in-ftcs-made-in-usa-enforcement-against-williams-sonoma/#more-2285 (accessed December 18, 2020).

16 O. C. Ferrell and Larry Gresham, “A Contingency Framework for Understanding Ethical Decision Making in Marketing,” *Journal of Marketing* 49 (Summer 1985), 89.

17 Starbucks, “Business Ethics and Compliance: Standards of Business Conduct,” https://www.starbucks.ph/media/Business-Ethics-and-Compliance-eng_tcm70-11290.pdf (accessed December 18, 2020).

18 “Kaiser Foundation Health Plan Will Pay $6.3 Million to Settle Medicare Advantage Fraud Allegations, Whistleblower Will Receive $1.5 Million,” December 2, 2020, https://www.whistleblowergov.org/healthcare-and-pharma.php?article=kaiser-foundation-health-plan-will-pay-6.3m-to-settle-medicare-advantage-fraud-allegations_182 (accessed December 18, 2020).

19 Michael Josephson, “Can Corporate Ethics Programs Do Any Good,” *Josephson Institute blog,* December 27, 2013, https://www.youtube.com/watch?v=b_yggZKGlpc (accessed December 18, 2020).

20 “Google, Alphabet, Pledge $14.5 Million to Address Racial Inequity,” *Philanthropy News Digest,* June 5, 2020, https://philanthropynewsdigest.org/news/google-alphabet-pledge-14.5-million-to-address-racial-inequity (accessed December 18, 2020).

21 Procter & Gamble, Tide’s Loads of Hope, http://www.tide.com/en-us/about-tide/loads-of-hope/about-loads-of-hope (accessed December 18, 2020).

22 P. Terry’s, https://pterrys.com/giving-back (accessed December 18, 2020).

23 Chris Kempczinski, “McDonald’s CEO: How We Are Thinking Differently about Our Role in Society,” *CNN,* November 25, 2020, https://www.cnn.com/2020/11/25/perspectives/mcdonalds-ceo-charity-values/index.html (accessed December 21, 2020).

24 Lieff Cabraser, “11th Circuit Upholds $41 Million Individual Verdict Against RJ Reynolds and Philip Morris in Florida Tobacco Lawsuit,” Lieff Cabraser Heimann & Bernstein, blog, March 24, 2020, https://www.lieffcabraser.com/2020/03/11th-circuit-upholds-41-million-individual-verdict-against-rj-reynolds-and-philip-morris-in-florida-tobacco-lawsuit/ (accessed December 22, 2020).

25 Isabella Kwai, “Consumer Groups Target Amazon Prime’s Cancellation Process,” *The New York Times,* January 14, 2021, https://www.nytimes.com/2021/01/14/world/europe/amazon-prime-cancellation-complaint.html (accessed January 21, 2021).

26 Larry Light, “Coca-Cola’s Brand-Business Rationalization,” *Forbes,* August 4, 2020, https://www.forbes.com/sites/larrylight/2020/08/04/coca-colas-brand-business-rationalization/?sh=5421e2423bca (accessed December 22, 2020); Toby Howell, “Coca-Cola Cuts ‘Zombie Brands’ From Its Portfolio,” *Morning Brew,* October 8, 2020, https://www.morningbrew.com/daily/stories/2020/10/08/cocacola-cuts-zombie-brands-portfolio (accessed December 22, 2020); “Brands,” Coca-Cola Company, https://www.coca-colacompany.com/brands (accessed December 22, 2020).

27 Robert Glazer, “CVS Lost $2 Billion with 1 Decision—Here’s Why They Were Right,” *Forbes,* April 21, 2020, https://www.forbes.com/sites/robertglazer/2020/04/21/cvs-lost-2-billion-with-1-decision-heres-why-they-were-right/ (accessed December 22, 2020).

28 Ryan Luckey, “This Pledge Day, Speak Up Against Distracted Driving,” *AT&T,* press release, September 19, 2019, https://www.itcanwait.com/inside_connections_blog/2019/09/it_can_wait_pledge_day.html (accessed December 22, 2020).

29 Brittany Baumann, “Midas Hospitality and Boone Center, Inc. Create Hospitality Program,” *HospitalityNet,* press release, January 31, 2020, https://www.hospitalitynet.org/news/4096804.html (accessed December 22, 2020).

30 “The 2017 WBI U.S. Workplace Bullying Survey,” Workplace Bullying Institute, 2017, https://workplacebullying.org/research-wbi/ (accessed December 23, 2020).

31 Lisa Evans, “Why the Office Bully Is Getting Promoted,” *Fast Company,* October 23, 2014, http://www.fastcompany.com/3037427/why-the-office-bully-is-getting-promoted (accessed December 23, 2020).

32 Robin Abcarian, “Just as We Thought: Richie Incognito Bullied Jonathan Martin,” *Los Angeles Times,* February 14, 2014, http://www.sbnation.com/nfl/2014/2/14/5411608/worst-of-the-richie-incognito-jonathan-martin-report-miami-dolphins (accessed December 23, 2020).

33 “Sexual Harassment,” U.S. Equal Employment Opportunity Commission, http://www.eeoc.gov/laws/types/sexual_harassment.cfm (accessed December 23, 2020).

34 Sheryl Estrada, “McDonald’s Hit with $500M Sexual Harassment Lawsuit,” *HR Dive,* April 15, 2020, https://www.hrdive.com/news/mcdonalds-hit-with-500m-sexual-harassment-lawsuit/576081/ (accessed December 23, 2020).

35 “Sexual Harassment Payouts Hit All-Time High in 2019,” Fisher Phillips law firm, blog, January 28, 2020, https://www.fisherphillips.com/resources-alerts-sexual-harassment-payouts-hit-all-time-high (accessed December 23, 2020).

36 Evans, “Why the Office Bully Is Getting Promoted.”

37 United States Courts, www.uscourts.gov/news/2016/12/22/environmental-crime-tops-list-organizations (accessed December 23, 2020).

38 Food and Drug Administration, “Food Loss and Waste,” https://www.fda.gov/food/consumers/food-loss-and-waste (accessed December 23, 2020); Jennifer Molidor, “Grocery Chains Need to Stop Buying into Food Waste,” *Grocery Dive,* November 9, 2020, https://www.grocerydive.com/news/grocery-chains-need-to-stop-buying-into-food-waste-heres-why/588082/ (accessed December 23, 2020); “Is ‘Ugly Produce’ the Key to Our Food Waste Problem?” *CBS News,* October 12, 2019, https://www.cbsnews.com/news/ugly-produce-the-key-to-our-food-waste-problem/ (accessed December 23, 2020).

39 “Company Fined for Ocean Pollution,” *The (Kuau’i) Garden Island,* February 11, 2020, https://www.thegardenisland.com/2020/02/11/business/company-fined-for-ocean-pollution/ (accessed December 23, 2020).

40 Kie Relyea, “EPA Fines Company in Lynden $41,500 for Releasing Pollutants into Fishtrap Creek,” *The Bellingham Herald,* June 25, 2020, https://www.bellinghamherald.com/news/local/article243775072.html (accessed December 30, 2020).

41 “Recycle Your Denim with Us,” Madewell, https://www.madewell.com/inspo-do-well-denim-recycling-landing.html (accessed December 30, 2020).

42 “Major Companies Using Green Energy in 2020,” *SaveOnEnergy,* May 18, 2020, https://www.saveonenergy.com/learning-center/post/major-companies-using-green-energy-2020/ (accessed December 30, 2020).

43 Chipotle, “Cultivate a Better World: 2019 Sustainability Report Update,” April 2020, 20200429_Chipotle_2020_SutainabilityReport_v14_R-compressed.pdf (accessed December 31, 2020); Peter Adams, “Chipotle Lets Diners Track Environmental Impact of Burritos as Restaurants Prioritize Sustainability,” *Marketing Dive,* October 26, 2020, https://www.marketingdive.com/news/chipotle-lets-diners-track-environmental-impact-of-burritos-as-restaurants/587745/ (accessed December 31, 2020).

44 Monica J. Stover, “Environmental Marketing Claims and the FTC’s ‘Revised Green Guides’,” *Michigan Environmental Law Journal,* 37 (Spring 2020), https://connect.michbar.org/envlaw/blogs/environmental-law-journal/2020/05/14/environmental-marketing-claims-and-the-ftcs-revise (accessed December 31, 2020).

45 “Environmental, Social and Governance Report, 2019,” Citi, p. 114, https://www.citigroup.com/citi/about/esg/download/2019/Global-ESG-Report-2019.pdf (accessed December 31, 2020).

46 “Tae Yoo,” Cisco, https://blogs.cisco.com/author/taeyoo (accessed December 31, 2020).

47 “People Planet Play: Caesar’s Entertainment 2019–2020 CSR Report,” Caesar’s Entertainment, https://drive.google.com/file/d/1WPpEu-SfHluUhCZ8W_cAyDiOauvib8-H/view?usp=sharing (accessed December 31, 2020).

48 Whole Foods Market, “This Is Whole Trade | Whole Foods Market,” *YouTube*, June 20, 2017, www.youtube.com/watch?v=WoD_OwrZpwU; Whole Foods Market, “Your Guide to the Whole Trade Guarantee,” www.wholefoodsmarket.com/mission-values/whole-trade-program; Whole Foods Market, “Whole Foods Market History,” www.wholefoodsmarket.com/company-info/whole-foods-market-history; Whole Foods Market, “Our Core Values,” www.wholefoodsmarket.com/mission-values/core-values; Whole Foods Market, “Quality Standards,” www.wholefoodsmarket

.com/quality-standards; Whole Foods Market, “Whole Benefits,” careers.wholefoodsmarket.com/global/en/benefits; Cale Guthrie Weissman, “Whole Foods Is Becoming ‘Whole Paycheck’ Once Again,” *Fast Company*, February 12, 2019, www.fastcompany.com/90305918/whole-foods-is-becoming-whole-paycheck-once-again; Andria Cheng, “Two Years After Amazon Deal, Whole Foods Is Still Working To Shed Its ‘Whole Paycheck’ Image,” *Forbes*, August 28, 2019, www.forbes.com/sites/andriacheng/2019/08/28/two-years-under-amazon-whole-foods-still-has-its-work-cut-out-to-erase-the-whole-paycheck-image/#74a254394227; Karen Weise, “Amazon Wants to Rule the Grocery Aisles, and Not Just at Whole Foods,” *The New York Times*, July 28, 2019, www.nytimes.com/2019/07/28/technology/whole-foods-amazon-grocery.html.

Chapter 3

1 Based on information in Heather Lalley, “International Starbucks Now Outnumber U.S. Units,” *Restaurant Business Magazine,* January 11, 2019, www.restaurantbusinessonline.com/operations/international-starbucks-now-outnumber-us-units; Starbucks, “Starbucks Company Profile,” www.starbucks.com/about-us/company-information/starbucks-company-profile; Starbucks, “Company Information,” www.starbucks.com/about-us/company-information; Kristin Salaky, “Starbucks Will Close 100 Additional U.S. Locations As It Continues To Adapt To Changing Consumer Habits,” *Delish*, November 2, 2020, www.delish.com/food-news/a34551483/starbucks-us-store-closures; Starbucks, “Starbucks Announces New Roasting Facility in China, Extending Its Global Roasting Network,” March 12, 2020, https://stories.starbucks.com/stories/2020/starbucks-announces-new-roasting-facility-in-china-extending-its-global-roasting-network.

2 “About the Coca-Cola Company,” Coca-Cola Company, https://investors.coca-colacompany.com/about (accessed January 7, 2021).

3 “Company Overview,” Combustion Associates, Inc., https://cai3.com/company-overview/ (accessed January 4, 2021).

4 “Liriope Factory,” Southern United States Trade Association, https://www.susta.org/resources/newsfactsandstats/successstories/liriope/ (accessed January 7, 2021).

5 U.S. Census Bureau, “U.S. International Trade in Goods and Services, December 2020,” February 5, 2021, https://www.bea.gov/news/2021/us-international-trade-goods-and-services-december-2020 (accessed February 23, 2021).

6 Ibid.

7 Jefferson Graham, “An iPhone Made in America? Why Building Apple’s Smartphone in the USA Is a ‘Pipe Dream’,” *USA Today,* July 28, 2019, https://www.usatoday.com/story/tech/talkingtech/2019/07/26/trump-tariff-threats-apple-iphone-made-america-unlikely/1838958001/ (accessed January 5, 2021).

8 “New Study: Trade Supported Over 40 Million Jobs,” *Business Roundtable,* October 5, 2020, https://www.businessroundtable.org/new-study-trade-supported-over-40-million-american-jobs (accessed January 6, 2021).

9 “U.S. Trade in Goods and Services—Balance of Payments (BOP) Basis,” U.S. Census Bureau, https://www.census.gov/foreign-trade/statistics/historical/gands.pdf (accessed January 6, 2021).

10 “World Economic Outlook, January 2021,” The International Monetary Fund, https://www.imf.org/en/Publications/WEO/Issues/2021/01/26/2021-world-economic-outlook-update (accessed February 22, 2021).

11 “Canada – Country Commercial Guide,” International Trade Association, August 3, 2020, https://www.trade.gov/knowledge-product/canada-market-overview (accessed January 6, 2021).

12 “Trade in Goods with European Union,” U.S. Census Bureau, https://www.census.gov/foreign-trade/balance/c0003.html (accessed February 22, 2021).

13 “Trade in Goods with South and Central America,” U.S. Census Bureau, https://www.census.gov/foreign-trade/balance/c0009.html (accessed February 22, 2021).

14 “Trade in Goods with Africa,” U.S. Census Bureau, https://www.census.gov/foreign-trade/balance/c0013.html (accessed February, 2021).

15 Chuck Cartmill, “Lights and Insights: Streetlight Company Expands into New Solutions,” Export Development Canada, blog, November 2, 2020, https://www.edc.ca/en/blog/led-roadway-lighting-cleantech-export-star.html (accessed January 8, 2021).

16 Szu Ping Chan, “When Pepsi Was Swapped for Soviet Warships,” BBCNews, June 13, 2019, https://www.bbc.com/news/business-48343589 (accessed March 2, 2021).

17 “About Us,” Dunkin’, https://www.dunkindonuts.com/en/about/about-us (accessed January 8, 2021).

18 Elizabeth Paton and Sapna Maheshwari, “H&M’s Different Kind of Clickbait,” *The New York Times,* December 18, 2019, https://www.nytimes.com/2019/12/18/fashion/hms-supply-chain-transparency.html (accessed January 12, 2021); “Supplier List,” H&M Group, https://hmgroup.com/sustainability/leading-the-change/supplier-list.html (accessed January 12, 2021).

19 James Bamford, Gerard Baynham, and David Ernst, “Joint Ventures and Partnerships,” *Harvard Business Review,* September–October 2020, pp. 116–124.

20 “GM, Honda Announce North America Car Alliance,” *Yahoo Finance,* September 3, 2020, https://autos.yahoo.com/gm-honda-announce-north-america-175938790.html (accessed January 12, 2021).

21 “U.S. Aluminum Industry Files Unfair Trade Cases Against Imports of Aluminum Foil from Five Countries,” Globe Newswire, press release, September 29, 2020, https://www.globenewswire.com/news-release/2020/09/29/2100714/0/en/U-S-Aluminum-Industry-Files-Unfair-Trade-Cases-Against-Imports-of-Aluminum-Foil-from-Five-Countries.html (accessed January 13, 2021).

22 Joy Kopcha, “Updated: All Tariffs on Chinese PLT Tires Will Remain,” *Modern Tire Dealer,* November 3, 2020, https://www.moderntiredealer.com/articles/31157-anti-dumping-tariffs-on-chinese-tires-will-remain (accessed January 13, 2021).

23 Josh Zumbrun and Bob Davis, “Tariffs on China Fail to Aid U.S. Factories,” *The Wall Street Journal,* October 26, 2020, p. A1.

24 “World Outlook Database,” International Monetary Fund, October 2020, https://www.imf.org/en/Publications/WEO/weo-database/2020/October/weo-report (accessed January 14, 2021).

25 Scott A. Burns, “Banking the Unbanked—Lessons from the Developing World,” *American Institute for Economic Research,* February 29, 2020, https://www.aier.org/article/banking-the-unbanked-lessons-from-the-developing-world/ (accessed January 15, 2021).

26 Dylan Lyons, “Brands in Translation: 9 Cringeworthy Language Fails,” *Babbel,* June 25, 2020, https://www.babbel.com/en/magazine/brand-language-fails (accessed January 15, 2021).

27 Andrew Chatzkey, James McBride, and Mohammed Aly Sergie, “NAFTA and the USMCA: Weighing the Impact of North American Trade,” Council on Foreign Relations, July 1, 2020, https://www.cfr.org/backgrounder/naftas-economic-impact (accessed January 18, 2021); “Fast Facts: U.S. Trade with Canada and Mexico,” USMCA Coalition, http://www.usmcacoalition.org/wp-content/uploads/2019/03/REVISED-USMCA-Coalition_Onepager-3.15.19.pdf (accessed January 18, 2021).

28 Katie Lobosco, Brian Fung, and Tami Luhby, “6 Key Differences Between NAFTA and the USMCA Deal that Replaces It,” *CNN,* December 17, 2019, https://www.cnn.com/2019/12/10/politics/nafta-us-mexico-canada-trade-deal-differences/index.html (accessed January 18, 2021); Ana Swanson, “As New NAFTA Takes Effect, Much Remains Undone,” *The New York Times,* July 1, 2020, https://www.nytimes.com/2020/07/01/business/economy/usmca-takes-effect.html (accessed January 18, 2021); “U.S. Relations with Canada,” U.S. Department of State, July 16, 2020, https://www.state.gov/u-s-relations-with-canada/ (accessed January 18, 2021); and “Fast Facts: U.S. Trade with Canada and Mexico.”

29 “Trade and Export,” Texas Economic Development, https://gov.texas.gov/business/page/trade-and-export (accessed January 20, 2021).

30 “About Citi,” Citi Group, https://www.citigroup.com/citi/about/ (accessed January 20, 2021).

31 “Keeping America Strong,” Export-Import Bank of the United States, 2019 Annual Report, https://www.exim.gov/sites/default/files/reports/annual/2019/ EXIM_2019%20AnnualReport_508C_Web.pdf (accessed January 20, 2021).

32 The World Bank, www.worldbank.org (accessed January 20, 2021).

33 Based on information in Past To Future, “Honda History - How Soichiro Honda Started Company,” *YouTube*, February 20, 2019, www.youtube.com/watch?v=31sN1NuoMI0; Honda, “History,” https://global.honda/about/profile/history.html; Honda, “Company Overview,” https://global.honda/about/profile.html; Michael Wayland, “GM, Honda Partner to Develop Two New All-Electric Vehicles,” *CNBC*, April 2, 2020, www.cnbc.com/2020/04/02/gm-honda-partner-to-develop-two-new-all-electric-vehicles.html; “Honda Accelerates Its ‘Electric Vision’ Strategy With New 2022 Ambition,” *Automotive World*, October 23, 2019, www.automotiveworld.com/news-releases/honda-accelerates-its-electric-vision-strategy-with-new-2022-ambition; Roberto Baldwin, “Honda Kills Clarity EV, Its Only All-Electric Car in U.S.,” *Car and Driver*, March 9, 2020, www.caranddriver.com/news/a31297220/honda-clarity-ev-discontinued.

34 Based on information from Amber Hunt, “As Graeter’s Celebrates 150 Years, Its Longevity Can Be Traced to One Stubborn Woman,” *Cincinnati Enquirer,* July 16, 2020, https://www.cincinnati.com/story/news/2020/07/16/graeters-celebrates-150-years-its-success-can-traced-one-woman/5393959002/; Kathie Canning, “Graeter’s Ice Cream Plant Is Different by Design,” *Dairy Foods,* October 4, 2019 https://www.dairyfoods.com/articles/93878-graeters-ice-cream-plant-is-different-by-design; “Graeter’s Manufacturing Co.,” Dun & Bradstreet, https://www.dnb.com/business-directory/company-profiles.graeters_manufacturing_co.34b374200d30ae53cea748c5da0fe772.html (accessed March 15, 2021); Kimberly L. Jackson, “Graeter’s Premium Chocolate Chip Ice Creams Land at Stop & Shop,” *Newark Star-Ledger (NJ),* April 4, 2012, https://www.nj.com/homegarden/2012/04/graeters_premium_ice_cream_lan.html; “Graeter’s Ice Cream Debuts in Bay Area,” *Tampa Bay Times (St. Petersburg, FL),* January 10. 2012, p. 4B; Jim Carper, “Graeter’s Runs a Hands-on Ice Cream Plant,” *Dairy Foods,* August 2011, pp. 36+; Jim Carper, “The Greater Good,” *Dairy Foods,* August 2011, pp. 95+; “Graeter’s Unveils New ‘Mystery Flavor’,” *Dayton Daily News,* March 29, 2012, www.daytondailynews.com; Bob Driehaus, “A Cincinnati Ice Cream Maker Aims Big,” *The New York Times,* September 11, 2010, www.nytimes.com; Lucy May. “Graeter’s Northern Kentucky Franchisee Puts Stores on the Block,” *Business Courier,* August 6, 2010, http://cincinnati.bizjournals.com; www.graeters.com; interviews with company staff and Cengage videos about Graeter’s.

Chapter 4

1 Based on information in Darrell Etherington, “Amazon to Acquire Autonomous Driving Startup Zoox,” *TechCrunch*, June 26, 2020, HYPERLINK “F:\www.techcrunch.com\2020\06\26\amazon-to-acquire-autonomous-driving-startup-zoox\;”www.techcrunch.com/2020/06/26/amazon-to-acquire-autonomous-driving-startup-zoox/; Sean O’Kane, “Zoox Unveils a Self-Driving Car That Could Become Amazon’s First Robotaxi,” *The Verge*, December 14, 2020, HYPERLINK “F:\www.theverge.com\2020\12\14\22173971\zoox-amazon-robotaxi-self-driving-autonomous-vehicle-ride-hailing”www.theverge.com/2020/12/14/22173971/zoox-amazon-robotaxi-self-driving-autonomous-vehicle-ride-hailing; Stephen Nellis and Jane Lanhee Lee, “Exclusive: Amazon Plans at Least $100 Million to Keep Zoox Talent After $1.3 Billion Deal,” *Reuters*, July 9, 2020, https://www.reuters.com/article/us-amazon-com-zoox-exclusive/exclusive-amazon-plans-at-least-100-million-to-keep-zoox-talent-after-1-3-billion-deal-idUSKBN24A3C8.

2 The SC Johnson website at https://www.scjohnson.com/ (accessed January 5, 2021).

3 The Procter & Gamble website at www.pg.com (accessed January 7, 2021).

4 The McDonald’s website at https://www.mcdonalds.com/us/en-us.html (accessed January 7, 2021).

5 The Mars Corporate website at www.mars.com (accessed January 8, 2021).

6 The My New Company website at www.mynewcompany.com (accessed January 5, 2021).

7 Andrew Willis, “The 10 Biggest IPOs of 2020,” the Morningstar website at www.morningstar.com (accessed December 15, 2020).

8 The Internal Revenue Service website at www.irs.gov (accessed January 10, 2021).

9 Colm Corey, “Pfizer Announces Joint Venture to Develop Coronavirus Vaccine,” The Silicon Republic website at https://www.siliconrepublic.com/innovation/pfizer-biontech-coronavirus-vaccine (accessed March 18, 2020).

10 Berkeley Lovelace, Jr., “FDA Approves Pfizer’s Covid Vaccine for Emergency Use as U.S. Reaches Pivotal Moment in the Pandemic,” The CNBC website at https://www.cnbc.com/2020/12/11/pfizer-covid-vaccine-approved-fda-emergency-use.html (accessed December 11, 2020).

11 The Walmart website at https://corporate.walmart.com/our-story/our-business (accessed January 6, 2021).

12 The Oracle website at www.oracle.com (accessed January 6, 2021).

13 Ian King and Liana Baker, “Cisco Buys Startup ThousandEyes to Add to Software Services,” the Yahoo! Finance website at https://finance.yahoo.com/news/cisco-buys-startup-thousandeyes-add-203147738.html (accessed May 28, 2020).

14 Paul Sawers, “13 Acquisitions Highlight Big Tech’s AI Talent Grab in 2020,” The VentureBeat website at https://venturebeat.com/2020/12/25/13-acquisitions-highlight-big-techs-ai-talent-grab-in-2020/ (accessed December 25, 2020).

15 Scott Carey, “Biggest Technology Acquisitions of 2020,” the Computerworld website at https://www.computerworld.com/article/3513439/biggest-technology-acquisitions-of-2020.html?page=2 (accessed December 15, 2020).

16 Based on information in SC Johnson, “Fisk Johnson, Current Chairman and CEO of SC Johnson,” www.scjohnson.com/en/a-family-company/the-johnson-family/fisk-johnson-current-chairman-and-ceo-of-sc-johnson-champions-innovation-and-transparency; SC Johnson, “Samuel Curtis Johnson: The Generous and Determined Founder of a Family Company,” www.scjohnson.com/en/a-family-company/the-johnson-family/samuel-curtis-johnson/samuel-curtis-johnson-the-generous-and-determined-founder-of-a-family-company; SC Johnson, “Fact Sheet: SC Johnson is a Great Place to Work,” www.scjohnson.com/en/our-news/fact-sheets/fact-sheet---sc-johnson-is-a-great-place-to-work; Caitlin Sievers, “SC Johnson Donated $20K a Day for 20 Days in a Row to End 2020; Six Racine-area Organizations Benefit,” *The Journal Times*, January 3, 2021, www.journaltimes.com/news/local/sc-johnson-donated-20k-a-day-for-20-days-in-a-row-to-end-2020/article_1ca890b3-9101-5f0a-b87c-b648b7b79a99.html; Lauren Anderson, “SC Johnson Doubles Its Commitment to Fight COVID-19 to $10 Million,” *BizTimes*, April 9, 2020, www.biztimes.com/sc-johnson-doubles-its-commitment-to-fight-covid-19-to-10-million/; SC Johnson, “SC Johnson’s Greenlist™ Program: Choosing Product Ingredients to Better Protect Human Health and the Environment,” April 19, 2018, www.scjohnson.com/en/our-purpose/environmental-responsibility-news/improving-products/sc-johnsons-greenlist-program-choosing-product-ingredients; “S.C. Johnson Joins with Coke, Walmart, Pepsi and Others to Implement ‘Circular Approach’ to Plastic Waste,” *The Journal Times*, December 20, 2020, www.journaltimes.com/news/local/s-c-johnson-joins-with-coke-walmart-pepsi-and-others-to-implement-circular-approach-to/article_e0cadd7a-77e9-5f79-8a6d-bb66ca28a848.html.

Chapter 5

1 Based on information in “2021 Fastest-Growing Franchises Ranking,” *Entrepreneur*, www.entrepreneur.com/franchises/fastestgrowing; Taco Bell, “Taco Bell History,” www.tacobell.com/history; Jonathan Maze, “Is the World Ready for Taco Bell?” *Restaurant Business*, May 31, 2019, www.restaurantbusinessonline.com/operations/world-ready-taco-bell; Lisa Fei, “How Taco Bell Is Becoming the World’s Most Innovative Franchise,” *Entrepreneur*, February 5, 2021, www.entrepreneur.com/article/364618; Danny Klein, “14 Glimpses Into the Fast-Food Restaurant of the Future,” *QSR*, January 2021, www.qsrmagazine.com/content/14-glimpses-fast-food-restaurant-future; Crew App, “Taco Bell Keeps the Frontline Connected,” www.crewapp.com/customers/taco-bell; Yum! Brands, “Taco Bell,” www.yum.com/wps/portal/yumbrands/Yumbrands/company/our-brands/taco-bell; Taco Bell, “Taco Bell® Unveils Plans For New, More Experiential Cantina Restaurant Concepts,” March 5, 2020, www.tacobell.com/news/fast-social-restaurants.

2 U.S. Small Business Administration, Office of Advocacy, “Frequently Asked Questions,” October 2020, https://cdn.advocacy.sba.gov/wp-content/uploads/2020/11/05122043/Small-Business-FAQ-2020.pdf (accessed January 26, 2021).

3 “How Much Income Can I Make as a Coffee Shop Owner?” Startmycoffeeshop.com, https://startmycoffeeshop.com/how-much-income-can-i-make-as-a-coffee-shop-owner/ (accessed January 26, 2021); “Starbucks Reports Q4 Fiscal Year 2020 Results,” Starbucks, https://stories.starbucks.com/press/2020/starbucks-reports-q4-fiscal-2020-results/ (accessed January 26, 2021).

4 U.S. Small Business Administration, Office of Advocacy, “Frequently Asked Questions.”

5 Ibid.

6 Ibid.

7 Ibid.

8 “Parson’s Newly Acquired Braxton Technologies Awarded Tibbitts Innovation Excellence,” *ThomasNet,* press release, January 26, 2021, https://news.thomasnet.com/companystory/parsons-newly-acquired-braxton-technologies-awarded-tibbetts-innovation-excellence-40042538 (accessed January 28, 2021).

9 U.S. Small Business Administration, Office of Advocacy, “Frequently Asked Questions.”

10 Tina Eaton, “The Bonobos Model: Lessons on Building a $300 MM D2C Brand,” Plytix, March 24, 2020, https://www.plytix.com/blog/bonobos-model (accessed January 28, 2021); “How Bonobos Went from DNVB Startup to $310M Acquisition Success,” *Trade Gecko,* November 13, 2018, https://www.tradegecko.com/blog/small-business-growth/how

-bonobos-went-from-dnvb-startup-to-310m-acquisition-success (accessed January 28, 2021).

11 “Meet the Winner: Small Businessperson of the Year,” Amazon, https://www.amazon.com/b/ref=s9_acss_bw_cg_sbp01_2a1_w?node=19900432011&pf_rd_m=ATVPDKIKX0DER&pf_rd_s=merchandised-search-5&pf_rd_r=599S187R53E5811S8XSK&pf_rd_t=101&pf_rd_p=6c000e06-602d-449d-bac8-17e9a3c661ba&pf_rd_i=19877629011 (accessed January 29, 2021).

12 “About Us—Post Surgery Apparel Store,” Renova, https://renovamedicalwear.com/pages/about-us-post-surgery-clothing-store (accessed January 29, 2021); “Meet the Winner: Small Business Owner Under 30 of the Year,” Amazon, https://www.amazon.com/b/ref=s9_acss_bw_cg_sbp01_2c1_w?node=19900443011&pf_rd_m=ATVPDKIKX0DER&pf_rd_s=merchandised-search-5&pf_rd_r=599S187R53E5811S8XSK&pf_rd_t=101&pf_rd_p=6c000e06-602d-449d-bac8-17e9a3c661ba&pf_rd_i=19877629011 (accessed January 29, 2021).

13 American Express, *The 2019 State of Women-Owned Business Report,* https://s1.q4cdn.com/692158879/files/doc_library/file/2019-state-of-women-owned-businesses-report.pdf (accessed February 1, 2021).

14 Tom Foster, “This Entrepreneur Hit Rock Bottom Before Building a Billion-Dollar Jewelry Empire (with Only $500),” *Inc.*, Winter 2018/2019, https://www.inc.com/magazine/201902/tom-foster/austin-texas-kendra-scott-jewelry-2018-surge-cities.html (accessed February 2, 2021).

15 American Express, *The 2019 State of Women-Owned Business Report.*

16 Melody Hahm, “Etsy Seller: ‘2020 Was One of the Best Years I’ve Ever Had’,” *Yahoo Finance,* December 23, 2020, https://www.yahoo.com/now/etsy-sellers-coronavirus-pandemic-ecommerce-boom-164811976.html (accessed February 1, 2021).

17 U.S. Small Business Administration website at https://www.sba.gov/tools/local-assistance/wbc (accessed February 1, 2021); SBA Office of Advocacy, “Women-Owned Spotlight Infographic,” August 14, 2017, www.sba.gov/sites/default/files/SBO_Facts_WOB.pdf (accessed February 1, 2021).

18 “It All Started with a Bath,” Da Bomb, https://dabombfizzers.com/pages/our-story (accessed February 2, 2021); “Teen Sisters Run a $20 Million Business Sellling Bath Bombs We All Need Right Now,” *Inside Edition,* January 16, 2021, https://www.insideedition.com/teen-sisters-run-a-20-million-business-selling-bath-bombs-we-all-need-right-now-63871 (accessed March 24, 2021); “Meet 16 Teen Founders Who Are Building Big Businesses—and Making Big Money,” *Entrepreneur,* August 20, 2019, https://www.entrepreneur.com/slideshow/337852 (accessed February 2, 2021).

19 “Jerry Yang,” *Forbes,* https://www.forbes.com/profile/jerry-yang/?sh=12202bdb468b (accessed February 3, 2021); “Yahoo’s Share Price Since Its IPO in 1996,” *The Atlas,* https://theatlas.com/charts/B1RjK9Q (accessed February 3, 2021).

20 Caleb Watney, “America’s Innovation Is Slowing,” *The Atlantic,* July 19, 2020, https://www.theatlantic.com/ideas/archive/2020/07/americas-innovation-engine-slowing/614320/ (accessed February 3, 2021); “Billion Dollar Companies Founded by Immigrants,” *Immigrant Founders,* https://immigrantfounders.com/unicorns/ (accessed February 3, 2021).

21 U.S. Small Business Administration, Office of Advocacy, “Frequently Asked Questions.”

22 Kerry Hannon, “It’s a Terrible Time for Small Businesses. Except When It’s Not,” *The New York Times,* December 14, 2020, https://www.nytimes.com/2020/12/14/business/smallbusiness/small-business-start-ups-entrepeneurs.html (accessed February 3, 2021).

23 U.S. Small Business Administration, Office of Advocacy, “Frequently Asked Questions.”

24 Timothy S. Hatten, *Small Business Management: Entrepreneurship and Beyond,* 5th ed., Copyright © 2012 by Cengage Learning. Reprinted with permission.

25 Joseph Pisani, “Amazon Founder Jeff Bezos to Step Down as CEO Later This Year,” *KVUE,* February 2, 2021, https://www.kvue.com/article/news/nation-world/jeff-bezos-out-as-ceo-amazon-andy-jassy-takes-over/507-21e15cee-74e3-408f-a708-c71ce3347412 (accessed February 5, 2021).

26 Dalvin Brown, “Franchises Help African-Americans ‘Level the Financial Playing Field’,” *USA Today,* February 11, 2020, https://www.usatoday.com/story/money/usaandmain/2020/02/11/franchises-african-american-small-business-success/2617860001/ (accessed February 5, 2021).

27 National Black McDonald’s Operators Association, https://nbmoa.org/ (accessed February 5, 2021).

28 “FAT Brands to Add Three Co-Branded Stores in Kansas,” *QSR,* December 2, 2020, https://www.qsrmagazine.com/news/fat-brands-add-three-co-branded-stores-kansas (accessed February 5, 2021).

29 “Taco Bell,” *Entrepreneur,* https://www.entrepreneur.com/franchises/tacobell/282858 (accessed February 8, 2021).

30 Jonathan Maze, “U.S. Franchisees Accuse Tim Hortons of ‘Price Gouging’,” *Restaurant Business,* February 28, 2020, https://www.restaurantbusinessonline.com/financing/us-franchisees-accused-tim-hortons-price-gouging (accessed February 8, 2021).

31 James Dornbrook, “H&R Block’s Latest Filing: A Lawsuit Against an Ex-Franchisee,” *Kansas City Business Journal,* February 26, 2020, https://www.bizjournals.com/kansascity/news/2020/02/26/hr-block-sues-former-franchisee-juan-cardenas-jr.html (accessed February 8, 2021).

32 Aryan Sharma, “Serena Williams Reveals How She Invests Into Companies,” *Essentially Sports,* June 6, 2020, https://www.essentiallysports.com/serena-williams-reveals-how-she-invests-into-companies-wta-tennis-news/ (accessed February 9, 2021); “Ignite Change,” Serena Ventures, https://www.serenaventures.com/ (accessed February 9, 2021).

33 “SBIC Overview,” U.S. Small Business Administration Office of Investment and Innovation, https://www.sba.gov/sites/default/files/2019-02/2019%20SBIC%20Overview%20Presentation.pdf (accessed February 9, 2021).

34 Lindsay Blakely, “With Little Cash to Spend, Some Businesses Turn to Zero-Cash Deals,” *Inc.,* May 22, 2020, https://www.inc.com/lindsay-blakely/bizx-bartering-trade-cash-flow.html (accessed February 10, 2021).

35 Gerri Detweiler, “Which Type of Crowdfunding Is Best for Your Small Business?” *Forbes,* January 9, 2020, https://www.forbes.com/sites/allbusiness/2020/01/09/small-business-crowdfunding/?sh=4ba2b25f600e (accessed February 10, 2021).

36 Brandon Gomez, “Latino-Owned Businesses Are Seeing Record Growth. Big Banks Are Still Not Funding Them,” *NBC News,* February 5, 2021, https://www.nbcnews.com/news/latino/latino-owned-businesses-are-seeing-record-growth-big-banks-are-n1256884 (accessed February 10, 2021).

37 “About SCORE,” SCORE, https://www.score.org/about-score (accessed February 10, 2021).

38 “Success Stories: Empanadas on the Go,” SCORE, https://www.score.org/success-story/empanadas-go (accessed February 10, 2021).

39 “Campus Connection: SBDC Helps Local Baker Launch Her Business,” *LaCrosse Tribune,* February 7, 2021, https://lacrossetribune.com/news/local/campus-connection-sbdc-helps-local-baker-launch-her-business/article_ab725029-76ae-59ba-b4a4-8511d15896ff.html (accessed February 11, 2021).

40 “Mi Casa Women’s Business Center Helps Jessica Acosta Achieve a Business Breakthrough,” SBA, https://www.sba.gov/offices/district/co/denver/success-stories/mi-casa-womens-business-center-helps-jessica-acosta-acheive-business-breakthrough (accessed February 11, 2021).

41 Beth M. Lederer, “SBA: Only 1 Percent of America’s Small Businesses Export Overseas,” *Inc.,* May 12, 2017, https://www.inc.com/associated-press/linda-mcmahon-small-business-administration-exports-only-1-percent-small-business.html (accessed February 12, 2021).

42 “A STEP to Finding Customers Overseas: Grants for Small Businesses,” Small Business Administration, https://www.sba.gov/blog/step-sbas-export-grant-program (accessed February 12, 2021).

43 Based on information in Billions, “Top 10 Most Successful Entrepreneurs In The World,” *YouTube*, August 23, 2020, www.youtube.com/watch?v=pMMbxhhxpFU; Ryan Robinson, “8 Surprising Traits of the World’s Most Successful Entrepreneurs,” *The Balance Small Business*, November 20, 2019, www.thebalancesmb.com/traits-of-world-s-most-successful-entrepreneurs-1200703; Evan Tarver, “Mark Zuckerberg Success Story: Net Worth, Education, and Influence,” *Investopedia*, January 31, 2020, www.investopedia.com/articles/personal-finance/081315/mark-zuckerberg-success-story-net-worth-education-top-quotes.asp; Leah Ginsberg, “How Mark Cuban Started With Just $60 in His Pocket and Became a Billionaire,” *CNBC*, July 5, 2017, www.cnbc.com/2017/07/05/how-mark-cuban-became-a-billionaire.html.

44 Based on information from Amber Hunt, “As Graeter’s Celebrates 150 Years, Its Longevity Can Be Traced to One Stubborn Woman,” *Cincinnati Enquirer,* July 16, 2020, https://www.cincinnati.com/story/news/2020/07/16/graeters-celebrates-150-years-its-success-can-traced-one-woman/5393959002/; Kathie Canning, “Graeter’s Ice Cream Plant Is Different by Design,” *Dairy Foods,* October 4, 2019, https://www.dairyfoods.com/articles/93878-graeters-ice-cream-plant-is-different-by-design; “Graeter’s Manufacturing Co.,” Dun & Bradstreet, https://www.dnb.com/business-directory/company-profiles.graeters_manufacturing_co

.34b374200d30ae53cea748c5da0fe772.html (accessed March 15, 2021); Kimberly L. Jackson, “Graeter’s Premium Chocolate Chip Ice Creams Land at Stop & Shop,” *Newark Star-Ledger (NJ),* April 4, 2012, https://www.nj.com/homegarden/2012/04/graeters_premium_ice_cream_lan.html; “Graeter’s Ice Cream Debuts in Bay Area,” *Tampa Bay Times (St. Petersburg, PL),* January 10, 2012, p. 4B; Jim Carper, “Graeter’s Runs a Hands-on Ice Cream Plant,” *Dairy Foods,* August 2011, pp. 36+; Jim Carper, “The Greater Good,” *Dairy Foods,* August 2011, pp. 95+; “Graeter’s Unveils New ‘Mystery Flavor’,” *Dayton Daily News,* March 29, 2012, www.daytondailynews. com; Bob Driehaus, “A Cincinnati Ice Cream Maker Aims Big,” *The New York Times,* September 11, 2010, www.nytimes.com; Lucy May, “Graeter’s Northern Kentucky Franchisee Puts Stores on the Block,” *Business Courier,* August 6, 2010, https://cincinnati.bizjournals.com; www.graeters.com; interviews with company staff and Cengage videos about Graeter’s.

Chapter 6

1 Based on information in Georgia Wells, “Twitter’s Jack Dorsey Survives Scrutiny From Activist Investor,” *The Wall Street Journal*, November 2, 2020, www.wsj.com/articles/jack-dorsey-will-remain-twitter-ceo-11604357141; Kirsten Grind and Georgia Wells, “Twitter’s Jack Dorsey: A Hands-Off CEO in a Time of Turmoil,” *The Wall Street Journal*, October 27, 2020, www.wsj.com/articles/twitters-jack-dorsey-a-hands-off-ceo-in-a-time-of-turmoil-11603822774; Lauren Feiner and Alex Sherman, “Twitter CEO Dorsey Keeps His Job After Company Strikes Investment Deal with Elliott Management, Silver Lake,” *CNBC*, March 9, 2020, www.cnbc.com/2020/03/09/twitter-strikes-investment-deal-with-elliott-management-silver-lake-after-attempt-to-oust-ceo-jack-dorsey.html.

2 Starbucks, https://www.starbucks.com/about-us/company-information/mission-statement (accessed January 22, 2021).

3 Amazon.com, https://www.aboutamazon.com/about-us (accessed February 2, 2021).

4 Nike, https://about.nike.com (accessed January 22, 2021).

5 Marguerite Ward, “Verizon Unveils New Business Plan with the Goal of Going Carbon Neutral by 2035 and Retraining 500,000 Employees for Emerging Tech Jobs,” *Business Insider*, July 14, 2020, https://www.businessinsider.com/verizon-unveils-socially-conscious-business-plan-citizen-verizon-2020-7l (accessed July 14, 2020).

6 Joshua Gans, “Why Elon Musks’s New Strategy Makes Sense,” *Harvard Business Review,* July 25, 2016, https://hbr.org/2016/07/why-elon-musks-new-strategy-makes-sense (accessed July 21, 2020); Nathan Furr and Jeff Dyer, “Lessons From Tesla’s Approach to Innovation,” *Harvard Business Review,* February 12, 2020, https://hbr.org/2020/02/lessons-from-teslas-approach-to-innovation (accessed July 21, 2020).

7 Mike Dano, “AT&T Preparing to Unveil Massive, Three-Year Cost-Cutting Plan,” *Light Reading,* March 3, 2020, https://www.lightreading.com/atandt-preparing-to-unveil-massive-three-year-cost-cutting-plan/d/d-id/757961 (accessed July 8, 2020).

8 Terri Langford, “How Disaster-Tested H-E-B Navigates the Coronavirus Pandemic,” KUT, March 26, 2020, https://www.kut.org/post/how-disaster-tested-h-e-b-navigates-coronavirus-pandemic (accessed July 14, 2020).

9 Seth Arenstein, “62% Have Crisis Plans, But Few Update Them or Practice Scenarios,” *PRNews,* February 5, 2020, https://www.prnewsonline.com/crisis-survey-CSA-practice (accessed July 14, 2020).

10 “Cisco: 100 Best Companies to Work For, 2020,” *Fortune*, https://fortune.com/best-companies/2020/cisco/ (accessed July 16, 2020); “Benefits and Perks,” *Cisco,* https://www.cisco.com/c/en/us/about/careers/we-are-cisco/benefits-and-perks.html (accessed July 16, 2020).

11 Ann Schmidt, “How Mary Barra Led GM Through Its 2014 Recall Scandal and Changed the Company’s Culture,” *Fox Business,* July 12, 2020, https://www.foxbusiness.com/money/mary-barra-gm-2014-recall-scandal-winning-formula (accessed July 22, 2020); Al Root, “Mary Barra Retooled GM to Keep It Profitable Through the Current Crisis,” *Barron’s,* June 26, 2020, https://www.barrons.com/articles/mary-barra-retooled-gm-to-keep-it-in-profitable-through-the-current-crisis-51593220965 (accessed July 22, 2020).

12 Ricky Griffin, *Fundamentals of Management*, 9th ed. (Mason, OH: Cengage, 2019), 5.

13 David Yaffe-Bellany, “The New Makers of Plant-Based Meat? Big Meat Companies,” *New York Times*, October 14, 2019, https://www.nytimes.com/2019/10/14/business/the-new-makers-of-plant-based-meat-big-meat-companies.html (accessed July 24, 2020).

14 Based on information in Visual Capitalist, “The History of Tesla in 5 Minutes,” *YouTube*, January 15, 2019, https://www.youtube.com/watch?v=pQiT2U5E9tI; Cadie Thompson and Kristen Lee, “Tesla Celebrates Its 10th Year as a Public Company Today. Here Are the Most Important Moments in Its History,” *Business Insider*, June 29, 2020, www.businessinsider.com/most-important-moments-tesla-history-2017-2; Andrew Greiner, Ivory Sherman, Tiffany Baker, Allie Schmitz, and Jen Tse, “The History of Tesla and Elon Musk: A Radical Vision for the Future of Autos,” *CNN*, March 22, 2019, www.cnn.com/interactive/2019/03/business/tesla-history-timeline/index.html; Charles Morris, “The Definitive Story of Tesla’s Beginnings, Told by Co-Founder Marc Tarpenning,” *Evannex*, June 18, 2017, https://evannex.com/blogs/news/the-definitive-story-of-tesla-s-beginnings-told-by-co-founder-marc-tarpenning; Chuck Squatriglia, “Tesla’s Founder Sues Tesla’s CEO,” *Wired*, June 11, 2009, www.wired.com/2009/06/eberhard/.

Chapter 7

1 Based on information in Dave Sebastian, “Coca-Cola Plans Layoffs, Offers Buyouts to U.S. Staff,” *The Wall Street Journal*, August 28, 2020, www.wsj.com/articles/coca-cola-plans-layoffs-offers-voluntary-separations-amid-reorganization-11598617149; The Coca Cola Company, “The Coca-Cola Company Announces Strategic Steps to Reorganize its Business for Future Growth,” August 28, 2020, www.coca-colacompany.com/press-releases/announcement-to-reorganize-for-future-growth; Amelia Lucas, “Coca-Cola Will Cut 2,200 Jobs Worldwide as Part of Restructuring Plan,” *CNBC*, December 17, 2020, www.cnbc.com/2020/12/17/coca-cola-will-cut-2200-jobs-worldwide-as-part-of-restructuring-plan.html; The Coca-Cola Company, “About The Coca-Cola Company,” investors.coca-colacompany.com/about.

2 “Structure and Governance,” Procter & Gamble, https://us.pg.com/structure-and-governance/corporate-structure/ (accessed January 25, 2021).

3 “Annual Report 2019,” Toyota, https://global.toyota/pages/global_toyota/ir/library/annual/2019_001_annual_en.pdf (accessed July 29, 2020).

4 Lawrence A. Cunningham and Stephanie Cuba, “How Warren Buffet Built a $500 Billion Company on the Basis of Trust,” *Marker,* January 14, 2020, https://marker.medium.com/how-warren-buffett-built-a-500-billion-company-on-the-basis-of-trust-753f02074665 (accessed July 30, 2020); David Larcker and Brian Tayan, “What It’s Like to Be Owned by Berkshire Hathaway,” *Harvard Business Review,* December 14, 2015, https://hbr.org/2015/12/what-its-like-to-be-owned-by-berkshire-hathaway (accessed July 31, 2020).

5 Shilpa Phadnis, “Infosys to Eliminate Roles to Flatten Organisation,” *Times of India*, June 1, 2020, https://timesofindia.indiatimes.com/business/india-business/infosys-to-cut-roles-flatten-co-for-speedy-decision-making/articleshow/76126971.cms (accessed July 31, 2020).

6 Dana Griffin, “Disadvantages of a Line & Staff Organization Structure,” *Small Business*, http://smallbusiness.chron.com/disadvantages-line-staff-organization-structure-2762.html (accessed August 11, 2020).

7 Ricky W. Griffin, *Fundamentals of Management*, 9th ed. (Boston, MA: Cengage, 2019), 356–357.

8 Benjamin Romano, “Two Pizza Teams and More: Former Amazon Employees Bake Bezos Principles Into Their Startups,” *Seattle Times*, November 18, 2019, https://www.seattletimes.com/business/amazon/two-pizza-teams-and-more-former-amazon-employees-bake-jeff-bezos-principles-into-their-startups/ (accessed August 14, 2020).

9 Based on information in Entrepreneur, “The Origin Story of Sweetgreen,” *YouTube*, March 5, 2020, www.youtube.com/watch?v=7Byd9UQFLIA; Andrea Kramar and Tom Huddleston Jr., “How These 33-Year-Olds Are Taking Sweetgreen From a Dorm Room Start-up to the ‘Starbucks of Salad’,” *CNBC*, March 13, 2019, www.cnbc.com/2019/03/13/sweetgreen-from-a-dorm-room-start-up-to-the-starbucks-of-salad.html; Daniela Galarza, “How Sweetgreen Got to $1 Billion,” *Eater*, November 15, 2018, www.eater.com/2018/11/15/18096104/sweetgreen-1-billion-unicorn-tech-company-lifestyle-brand; Amy Farley, “The Winner of the Fast-Casual Salad Wars? Sweetgreen, With 91 Restaurants in 8 States, and a Network of 150 Farmers,” *Fast Company*, February 19, 2019, www.fastcompany.com/90298904/sweetgreen-most-innovative-companies-2019.

Chapter 8

1. Based on information in Christopher Mims, "Not Even a Pandemic Can Slow Down the Biggest Tech Giants," *The Wall Street Journal*, May 23, 2020, www.wsj.com/articles/not-even-a-pandemic-can-slow-down-the-biggest-tech-giants-11590206412; Taylor Soper, "As Shopify Continues To Boom, Amazon Acquires Selz, a Startup That Helps E-Commerce Businesses," *GeekWire*, February 16, 2021, www.geekwire.com/2021/amazon-acquires-selz-shopify-competitor-helps-small-e-commerce-businesses; Justin Fox, "Amazon Spends Billions on R&D. Just Don't Call It That," *Bloomberg*, February 11, 2021, www.bloomberg.com/opinion/articles/2021-02-11/amazon-spends-billions-on-r-d-just-don-t-call-it-that.
2. The Bureau of Labor Statistics website at https://data.bls.gov/pdq/SurveyOutputServlet (accessed February 1, 2021).
3. Ibid.
4. "Industry Output and Employment," The Bureau of Labor Statistics website at www.bls.gov (accessed February 1, 2021).
5. "Top 10 Largest Manufacturing Nations in the World," Plant Automation Technology website at https://www.plantautomation-technology.com/articles/top-10-largest-manufacturing-nations-in-the-world-in-2020 (accessed February 1, 2021).
6. "Global Manufacturing Scorecard: How the U.S. Compares to 18 Other Countries," The Brooking Institute website at brookings.edu/research/global-manufacturing-scorecard-how-the-us-compares-to-18-other-nations/bid (accessed January 28, 2021).
7. "Top 18 Facts About Manufacturing," The National Association of Manufacturers website at https://www.nam.org/facts-about-manufacturing/ (February 1, 2021).
8. "Contributions of Key Economic Sector Recognized on Manufacturing Day," U.S. Census Bureau website at https://www.census.gov/library/stories/2020/10/manufacturing-still-among-top-five-united-states-employers.html (accessed February 1, 2021).
9. "Top 18 Facts About Manufacturing," The National Association of Manufacturers website at https://www.nam.org/facts-about-manufacturing/ (accessed February 1, 2021).
10. Ibid.
11. The Bureau of Labor Statistics website at https://www.bls.gov/ (accessed February 3, 2021).
12. Ian Linton, "Five Differences Between Service and Manufacturing Organizations," the *Houston Chronicle* website at https://smallbusiness.chron.com/five-differences-between-service-manufacturing-organizations-19073.html (accessed March 7, 2019).
13. The 3M Corporation website at www.3m.com (accessed February 2, 2021).
14. Jill Jusko, "America's New Factory Building Frenzy," *Industry Week* website at https://www.industryweek.com/leadership/media-gallery/22025813/americas-new-factory-building-frenzy (accessed February 2, 2021).
15. "GM Recognizes Suppliers for Delivering World-Class Innovation and Quality," the General Motors website at https://www.automotiveworld.com/news-releases/gm-honors-top-global-suppliers-for-innovation-and-performance/ (accessed June 24, 2020).
16. The Berry Plastics Corporation website at https://catalog.berryglobal.com/products/drinkcup (accessed February 1, 2021).
17. "Everyone Is Part of the Story—AT&T Diversity and Inclusion Annual Report 2019," the AT&T website at https://about.att.com/ecms/dam/pages/Diversity/Annual_Report/ATT_DI_2019_Annual_Report.pdf, (accessed February 3, 2021).
18. "What Makes Six Sigma Work," the iSixSigma website at https://www.isixsigma.com/ (accessed February 8, 2021).
19. The International Organization of Standardization (ISO) website at https://www.iso.org/home.html (accessed February 2, 2021).
20. "Productivity Change in the Manufacturing Sector," the Bureau of Labor Statistics website at www.bls.gov (accessed February 4, 2021).
21. Ibid.
22. Ibid.
23. "China Is Closing the Gap with the U.S. in R&D Expenditure," the Research America website at https://www.researchamerica.org/news-events/china-closing-gap-us-rd-expenditure-infographic (accessed January 27, 2020).
24. "Robotics in Manufacturing: How Robots Play a Role in The Assembly Line," the Robots.Net website at https://robots.net/robotics/robotics-in-manufacturing/ (accessed February 4, 2021).
25. The Sauder website at https://www.sauder.com/ (accessed February 12, 2021).
26. Based on information in Bloomberg Quicktake, "How Toyota Changed the Way We Make Things," *YouTube*, August 23, 2018, www.youtube.com/watch?v=F5vtCRFRAK0; Anjani Trivedi, "Toyota Broke Its Just-in-Time Rule Just in Time for the Chip Shortage," *Bloomberg*, February 15, 2021, https://www.bloomberg.com/opinion/articles/2021-02-15/toyota-broke-its-just-in-time-rule-just-in-time-for-the-chip-shortage; Toyota, "Toyota Production System," www.toyota-europe.com/world-of-toyota/this-is-toyota/toyota-production-system.
27. Based on information from the Graeter's website at www.graeters.com (accessed February 10, 2021); "Graeter's Ice Cream," the Dun & Bradstreet website at https://www.dnb.com/business-directory/top-results.html?term=graeters&page=1 (accessed February 11, 2021); "Graeter's Ice Cream Plant Is Different by Design," the Dairy Foods website at https://www.dairyfoods.com/articles/93878-graeters-ice-cream-plant-is-different-by-design (accessed February 12, 2021); Billy Kobin, "Graeter's Ice Cream Takes Over Its Last Remaining Franchisee," *Courier Journal* website at https://www.courier-journal.com/story/money/companies/2018/09/24/graeters-ice-cream-buys-last-remaining-kentucky-franchise-stores/1415877002/, September 24, 2018; Kimberly L. Jackson, "Graeter's Premium Chocolate Chip Ice Creams Land at Stop & Shop," *Newark Star-Ledger (NJ),* April 4, 2012, https://www.nj.com/homegarden/2012/04/graeters_premium_ice_cream_lan.html; "Graeter's Ice Cream Debuts in Bay Area," *Tampa Bay Times (St. Petersburg, FL),* January 10, 2012, p. 4B; Jim Carper, "Graeter's Runs a Hands-on Ice Cream Plant," *Dairy Foods,* August 2011, pp. 36 1; Bob Driehaus, "A Cincinnati Ice Cream Maker Aims Big," *New York Times,* September 11, 2010, www. nytimes.com; interviews with company staff and Cengage videos about Graeter's.

Chapter 9

1. Based on information in Aman Kidwai, "Chipotle to Expand Paid Parental Leave, Test Unlimited PTO," *HR Dive,* March 6, 2020, www.hrdive.com/news/chipotle-to-expand-paid-parental-leave-test-unlimited-pto/573585/; Chipotle, "Chipotle Enhances Paid Parental Leave and Tests Unlimited PTO," March 5, 2020, newsroom.chipotle.com/2020-03-05-Chipotle-Enhances-Paid-Parental-Leave-And-Tests-Unlimited-PTO; Chipotle, "Benefits," https://jobs.chipotle.com/benefits.
2. *Labor Force Characteristics by Race and Ethnicity, 2019,* U.S. Department of Labor, Bureau of Labor Statistics, December 2020, https://www.bls.gov/opub/reports/race-and-ethnicity/2019/home.htm (accessed February 18, 2021); *Women in the Labor Force: A Data Book,* U.S. Department of Labor, Bureau of Labor Statistics, December 2019, https://www.bls.gov/opub/reports/womens-databook/2019/home.htm (accessed February 18, 2021).
3. *Women in the Labor Force: A Data Book.*
4. Pippa Stevens, "Companies Are Making Bold Promises About Greater Diversity, but There's a Long Way to Go," *CNBC,* June 11, 2020, https://www.cnbc.com/2020/06/11/companies-are-making-bold-promises-about-greater-diversity-theres-a-long-way-to-go.html (accessed August 21, 2020).
5. Chauncey Alcorn, "Target Plans to Increase Its Black Workforce by 20% over the Next Three Years," *CNN,* September 10, 2020, https://www.cnn.com/2020/09/10/business/target-black-diversity/index.html (accessed September 23, 2020).
6. Luz Corona, "Verizon Chief Diversity Officer on Her Unique Role to Shape the Future," *Adweek,* January 25, 2021, https://www.adweek.com/inside-the-brand/verizon-chief-diversity-officer-on-her-unique-role-to-shape-the-future/ (accessed February 18, 2021).
7. "Taco Bell Hiring Parties," Taco Bell, https://hiringparties.tacobell.com/ (accessed August 25, 2020).
8. Susan M. Heathfield, "Using Social Media for Recruiting, Screening, and Background Checks," *The Balance Careers,* July 5, 2020, https://www.thebalancecareers.com/social-media-recruiting-1919153#citation-2 (accessed August 25, 2020).
9. Kate Rockwood, "How to Create an Effective Onboard Program," *SHRM,* May 22, 2020, https://www.shrm.org/hr-today/news/hr-magazine/summer2020/Pages/creating-an-effective-onboarding-program.aspx (accessed September 15, 2020).
10. Alan Murray, "Why PayPal's Dan Schulman Gave Workers Pay Increases, Without the Market Requiring It," September 10, 2020, https://fortune.com/2020/09/09/paypal-dan-schulman-stakeholder-capitalism-ceo-daily/ (accessed September 17, 2020).
11. Nancy Luna, "'Appreciation Bonuses' Coming to McDonald's Corp. Restaurant Workers During Coronavirus Pandemic," *Nation's Restaurant News,* May 7, 2020, https://www.nrn.com/quick-service/appreciation

-bonuses-coming-mcdonald-s-corp-restaurant-workers-during-coronavirus (accessed September 18, 2020).

12 Hormel Foods, "Hormel Foods Annual Tradition of Sharing Profits with Its Team Members Continues," press release, November 25, 2020, https://investor.hormelfoods.com/news-events/press-releases/news-details/2019/Hormel-Foods-Annual-Tradition-of-Sharing-Profits-With-Its-Team-Members-Continues/default.aspx (accessed February 18, 2021).

13 Jessica Dickler, "Gender Wage Gap Narrows But Shows No Signs of Going Away," *CNBC,* March 5, 2020, https://www.cnbc.com/2020/03/05/gender-wage-gap-narrows-but-shows-no-signs-of-going-away.html (accessed September 21, 2020).

14 Robin Bleiweis, "Quick Facts about the Gender Wage Gap," *Center for American Progress,* March 24, 2020, https://www.americanprogress.org/issues/women/reports/2020/03/24/482141/quick-facts-gender-wage-gap/ (accessed September 21, 2020).

15 Monica Langley and Marc Benioff, "How Salesforce Closed the Pay Gap Between Men and Women," *Wired,* October 15, 2019, https://www.wired.com/story/how-salesforce-closed-pay-gap-between-men-women/ (accessed September 22, 2020).

16 Elana Lynn Gross, "Tech Companies Are Sharing Gender Pay Data—But Oracle Is Resisting," *Forbes,* November 15, 2019 https://www.forbes.com/sites/elanagross/2019/11/15/tech-companies-are-increasingly-sharing-gender-pay-data--but-oracle-is-resisting/#340e41cb3faa (accessed September 22, 2020); Stephen Johnson, "'Gender Pay Scorecard' Grades 50 Major Companies," *BigThink,* March 31, 2020, https://bigthink.com/culture-religion/gender-pay-gap?rebelltitem=1#rebelltitem1 (accessed September 22, 2020).

17 Langley and Benioff, "How Salesforce Closed the Pay Gap."

18 "Employer Costs for Employee Compensation Summary," U.S. Department of Labor, Bureau of Labor Statistics, press release, September 17, 2020, https://www.bls.gov/news.release/ecec.nr0.htm (accessed September 24, 2020).

19 Conor Cawley, "20 Best Companies for Employee Benefits and Perks," *Tech.co*, May 13, 2020, https://tech.co/performance-management-software/best-companies-employee-perks-benefits (accessed September 24, 2020).

20 Lori Freifeld, "Dollar General Does It Again!" *Training*, March/April 2020, pp. 22–25; "Dollar General Earns Top Spot on *Training*, Magazine's Top 125 List for Second Consecutive Year," press release, February 25, 2020, via BusinessWire, https://www.businesswire.com/news/home/20200225005351/en/Dollar-General-Earns-Top-Spot-Training-Magazine%E2%80%99s (accessed September 25, 2020).

21 "2020 Training Industry Report," *Training*, November/December 2020, p. 22.

22 Kathleen Doheny, "Annual Performance Review Bows Out," *Society for Human Resource Management,* January 12, 2021, https://www.shrm.org/resourcesandtools/hr-topics/people-managers/pages/ditching-the-annual-performance-review-.aspx (accessed February 25, 2021).

23 Christopher Zara, "AirBnB Lays Off 25% of Its Workforce in a Dramatic Retrenchment for the COVID-19 Era," *Fast Company,* May 5, 2020, https://www.fastcompany.com/90501357/airbnb-lays-off-25-of-its-workforce-in-a-dramatic-retrenchment-for-the-covid-19-era (accessed September 28, 2020).

24 Rakesh Kochhar, "Women's Lead in Skills and Education Is Helping Narrow the Gender Wage Gap," *Pew Research Center*, January 30, 2020, https://www.pewsocialtrends.org/2020/01/30/womens-lead-in-skills-and-education-is-helping-narrow-the-gender-wage-gap/#: (accessed February 18, 2021); Gabrielle Olya, "25 Female Fortune 500 CEOs," *MSN Money*, March 8, 2021, https://www.msn.com/en-us/money/companies/25-female-fortune-500-ceos/ss-BB1emRCB (accessed March 12, 2021).

25 Equal Employment Opportunity Commission, "Jet Propulsion Laboratory to Pay $10 Million to Settle EEOC Age Discrimination Lawsuit," press release, June 11, 2020, https://www.eeoc.gov/newsroom/jet-propulsion-laboratory-pay-10-million-settle-eeoc-age-discrimination-lawsuit (accessed September 28, 2020).

26 Josh Cunningham, "ADA Turns 30: Supporters Celebrate Progress for Those with Disabilities," July 8, 2020, *National Conference of State Legislatures,* https://www.ncsl.org/research/labor-and-employment/the-ada-turns-30-magazine2020.aspx (accessed September 29, 2020).

27 Based on information in 23 ABC News, "Kern Back in Business: Taco Bell Hiring 250 New Employees," *YouTube,* April 22, 2019, www.youtube.com/watch?v=12kYhuireDw; "Taco Bell® Restaurants Hosting Nearly 600 Hiring Parties Across the Country in Time for Summer Hiring," *PR Newswire,* April 4, 2019, www.prnewswire.com/news-releases/taco-bell-restaurants-hosting-nearly-600-hiring-parties-across-the-country-in-time-for-summer-hiring-300824393.html; Kristin Salaky, "Taco Bell Is Hiring 30,000 Workers This Summer, With Some Newly Created Positions," *Delish,* May 21, 2020, www.delish.com/food-news/a32631233/taco-bell-hiring-summer-2020; Lisa Fei, "How Taco Bell Is Becoming the World's Most Innovative Franchise," *Entrepreneur,* February 5, 2021, www.entrepreneur.com/article/364618; Danny Klein, "14 Glimpses Into the Fast-Food Restaurant of the Future," *QSR,* January 2021, www.qsrmagazine.com/content/14-glimpses-fast-food-restaurant-future; Crew App, "Taco Bell Keeps the Frontline Connected," www.crewapp.com/customers/taco-bell; Nicole Duncan, "Inside Taco Bell's Innovative Approach to Labor," *QSR,* January 2019, www.qsrmagazine.com/employee-management/inside-taco-bells-innovative-approach-labor.

Chapter 10

1 Based on information in Catherine Clifford, "Whole Foods CEO John Mackey: Store Managers Could Be Making 'Well Over $100,000,' Without a College Degree," *CNBC*, November 5, 2020, www.cnbc.com/2020/11/05/ceo-john-mackey-on-how-much-you-can-make-working-at-whole-foods.html; Susan Dominus, "Breaking the Salary Sharing Taboo," *The New York Times*, February 19, 2020, www.nytimes.com/interactive/2020/02/19/magazine/salary-sharing.html; "How to Make Pay Transparency Part of HR Strategy: Featuring Starbucks, BBC, Whole Foods, Etc.," *HR Technologist*, March 30, 2020, www.hrtechnologist.com/articles/hr-compliance/pay-transparency-hr-strategy/.

2 "100 Best Companies to Work For," *Fortune*, 2020, http://fortune.com/best-companies/ (accessed February 19, 2021).

3 "12 Companies That Offer Part-Time Jobs with Benefits," *Indeed Career Guide,* June 1, 2020, https://www.indeed.com/career-advice/finding-a-job/companies-that-offer-part-time-jobs-with-benefits (accessed October 1, 2020).

4 Nick Davidson, "The 50 Best Places to Work," *Outside,* November 4, 2019, https://www.outsideonline.com/2404274/best-places-to-work-2019 (accessed October 1, 2020).

5 Ricky W. Griffin, *Fundamentals of Management*, 9th ed. (Mason, OH: Cengage Learning, 2019), 269–270.

6 Natallie Rocha, "Survey Says: Corporate Culture Is Worth More Than a Big Salary," *Fortune,* July 11, 2019, https://fortune.com/2019/07/11/corporate-culture-salary-jobs/ (accessed October 6, 2020).

7 Partially from "Southwest Careers: Culture," Southwest Airlines, https://careers.southwestair.com/culture (accessed October 9, 2020).

8 Lindsay McGregor and Neel Doshi, "How Company Culture Shapes Employee Motivation," *Harvard Business Review,* November 25, 2015, https://hbr.org/2015/11/how-company-culture-shapes-employee-motivation (accessed October 9, 2020).

9 Kim S. Cameron and Robert E. Quinn, *Diagnosing and Changing Organizational Culture* (San Francisco: Jossey-Bass, 2006).

10 Evan Nicole Brown, "Nike Debuts a Groundbreaking New Modesty Swimsuit," *Fast Company,* December 10, 2019, https://www.fastcompany.com/90440805/nike-debuts-a-groundbreaking-new-modesty-swimsuit (accessed October 9, 2020).

11 U.S. Bureau of Labor Statistics, "Unpaid Eldercare in the United States," press release, November 22, 2019, https://www.bls.gov/news.release/elcare.nr0.htm (accessed October 13, 2020).

12 Richard Eisenberg, "The 4-Day Workweek: Has Its Time Come?" *Forbes,* February 6, 2020, https://www.forbes.com/sites/nextavenue/2020/02/06/the-4-day-workweek-has-its-time-come/#4c5ccd4451d0 (accessed October 15, 2020).

13 Jessica Howington, "How Flexible Work Benefits Companies and Employees," *FlexJobs*, August 20, 2020, *https://www.flexjobs.com/employer-blog/the-benefits-of-allowing-employees-a-flexible-schedule/ (accessed October 15, 2020)*.

14 "2020 100 Best Companies," *Working Mother*, September 15, 2020, https://www.workingmother.com/best-companies-deloitte (accessed October 16, 2020); Michelle Parmelee, "Flex Work Is a Frontline Solution—and Not Just in a Crisis," *Forbes,* March 20, 2020, https://www.forbes.com/sites/deloitte/2020/03/20/flex-work-is-a-frontline-solution-and-not-just-in-a-crisis/#791e47432a9a (accessed October 16, 2020).

15 Kate Lister, "Latest Work-At-Home/Telecommuting/Mobile Work/Remote Work Statistics," Global Workplace Analytics, March 2020, http://globalworkplaceanalytics.com/telecommuting-statistics (accessed October 20, 2020).

16 Dave Nevogt, "Are Remote Workers More Productive? We've Checked all the Research so You Don't Have To," Hubstaff, August 31, 2020, http://blog.hubstaff.com/remote-workers-more-productive/ (accessed October 20, 2020).

17 Nichole Bernier, “The Remote Work Experiment That Upped Productivity 13%,” BBC, July 10, 2020, https://www.bbc.com/worklife/article/20200710-the-remote-work-experiment-that-made-staff-more-productive (accessed October 20, 2020); Nicholas Bloom, “To Raise Productivity, Let More Employees Work at Home,” *Harvard Business Review,* 92 (January-February 2014), pp. 28-29; Nevogt, “Are Remote Workers More Productive? We’ve Checked all the Research so You Don’t Have To.”

18 National Center for Employee Ownership, “Employee Ownership by the Numbers,” September 2020, https://www.nceo.org/articles/employee-ownership-by-the-numbers (accessed October 21, 2020).

19 Based on information in The World, “What Perks Does Google Offer Its Employees,” *YouTube,* October 24, 2020, www.youtube.com/watch?v=qtSKknnW8I8; Tech Vision, “Inside Google’s Massive Headquarters,” *YouTube,* November 18, 2020, www.youtube.com/watch?v=Z-pT0XDYvDM; Rob Copeland and Peter Grant, “Google to Keep Employees Home Until Summer 2021 Amid Coronavirus Pandemic,” *The Wall Street Journal,* July 27, 2020, www.wsj.com/articles/google-to-keep-employees-home-until-summer-2021-amid-coronavirus-pandemic-11595854201; “The Top 10 Reasons to Work at Google,” *Investopedia,* September 19, 2020, www.investopedia.com/articles/investing/060315/top-10-reasons-work-google.asp; Susan Wojcicki, “The Eight Pillars of Innovation,” *Think with Google,* July 2011, https://www.thinkwithgoogle.com/future-of-marketing/creativity/8-pillars-of-innovation; Afdhel Aziz, “How Google.Org Fellows Are Helping Use The Power Of Data For Criminal Justice Reform,” *Forbes,* June 16, 2020, www.forbes.com/sites/afdhelaziz/2020/06/16/how-googleorg-fellows-are-helping-use-the-power-of-data-for-criminal-justice-reform.

20 Vanessa DiMauro and Adam Zawel, “Social Media for Strategy-Focused Organizations,” *Leader Networks*, June 19, 2014, http://www.leadernetworks.com/2014/06/social-media-for-strategy-focused-organizations.html (accessed February 19, 2021).

21 Based on information from Amber Hunt, “As Graeter’s Celebrates 150 Years, Its Longevity Can Be Traced to One Stubborn Woman,” *Cincinnati Enquirer,* July 16, 2020, https://www.cincinnati.com/story/news/2020/07/16/graeters-celebrates-150-years-its-success-can-traced-one-woman/5393959002/; Kathie Canning, “Graeter’s Ice Cream Plant Is Different by Design,” *Dairy Foods,* October 4, 2019 https://www.dairyfoods.com/articles/93878-graeters-ice-cream-plant-is-different-by-design; “Graeter’s Manufacturing Co.,” Dun & Bradstreet, https://www.dnb.com/business-directory/company-profiles.graeters_manufacturing_co.34b374200d30ae53cea748c5da0fe772.html (accessed March 15, 2021); Alexander Coolidge, “Graeter’s Pitches Its Products Nationwide,” *Cincinnati Enquirer,* June 20, 2014, http://www.cincinnati.com/story/money/2014/06/18/graeters-pitches-product-nationwide/10820875/; Kimberly L. Jackson, “Graeter’s Premium Chocolate Chip Ice Creams Land at Stop & Shop,” *Newark Star-Ledger (NJ)*, April 4, 2012, https://www.nj.com/homegarden/2012/04/graeters_premium_ice_cream_lan.html; “Graeter’s Ice Cream Debuts in Bay Area,” *Tampa Bay Times (St. Petersburg, FL)*, January 10, 2012, p. 4B; Jim Carper, “Graeter’s Runs a Hands-on Ice Cream Plant,” *Dairy Foods*, August 2011, pp. 36+; Jim Carper, “The Greater Good,” *Dairy Foods*, August 2011, pp. 95+; “Graeter’s Unveils New ‘Mystery Flavor’,” *Dayton Daily News*, March 29, 2012, www.daytondailynews.com; Bob Driehaus, “A Cincinnati Ice Cream Maker Aims Big,” *The New York Times*, September 11, 2010, www.nytimes.com; Lucy May, “Graeter’s Northern Kentucky Franchisee Puts Stores on the Block,” *Business Courier*, August 6, 2010, http://cincinnati.bizjournals.com; www.graeters.com (accessed February 19, 2021); interviews with company staff and Cengage videos about Graeter’s.

Chapter 11

1 Based on information in Netflix Research, “Personalization & Search,” https://research.netflix.com/business-area/personalization-and-search; Jeremy Bowman, “Netflix Is Killing the Competition in This One Key Category,” *The Motley Fool,* September 15, 2020, www.fool.com/investing/2020/09/15/netflix-is-killing-the-competition-in-this-one-key; Tara Lachapelle, “Netflix Investors, We Need to Talk About Churn,” *Bloomberg,* January 19, 2021, www.bloomberg.com/opinion/articles/2021-01-19/netflix-hbo-max-disney-face-reckoning-with-churn.

2 “Definitions of Marketing,” American Marketing Association, https://www.ama.org/the-definition-of-marketing-what-is-marketing/ (accessed February 19, 2021).

3 Bryan Pearson, “12 Ways Starbucks’ Loyalty Program Has Impacted the Retail Industry,” *Forbes,* December 16, 2020, https://www.forbes.com/sites/bryanpearson/2020/12/16/12-holiday-gifts-from-the-starbucks-card/?sh=178e743d4534 (accessed February 20, 2021); Bernard Marr, “Starbucks: Using Big Data, Analytics and Artificial Intelligence to Boost Performance,” *Forbes,* May 28, 2018, https://www.forbes.com/sites/bernardmarr/2018/05/28/starbucks-using-big-data-analytics-and-artificial-intelligence-to-boost-performance/#d56e82a65cdc (accessed February 20, 2021).

4 V. Kumar, *Customer Lifetime Value* (Hanover, MA: now Publishers, 2008), p. 5.

5 Rajkumar Venkatesan and V. Kumar, “A Customer Lifetime Value Framework for Customer Selection and Resource Selection and Resource Allocation Strategy,” *Journal of Marketing 68* (October 2004), 106–125.

6 Walter Loeb, “Nordstrom’s Management Sets a High Target for 2021,” *Forbes,* February 8, 2021, https://www.forbes.com/sites/walterloeb/2021/02/08/nordstroms-management-sets-a-high-target-for-2021/?sh=3444b8e63b57 (accessed February 20, 2021); Rina Raphael, “Nordstrom Local Expands Its Innovative, Inventory-Free Retail Hubs,” *Fast Company,* July 9, 2018, https://www.fastcompany.com/90180401/exclusive-nordstom-expands-its-innovative-inventory-free-service-hubs (accessed February 20, 2021).

7 Nikki Gilliland, “30 Brand Strategies with Excellent Social Media Strategies,” *Econsultancy,* June 25, 2020, https://econsultancy.com/30-brands-with-excellent-social-media-strategies/ (accessed October 28, 2020); Taylen Peterson, “How Social Media Customer Success Impacts Retention,” *Instapage,* January 3, 2020, https://instapage.com/blog/social-media-customer-success (accessed October 29, 2020).

8 Hau L. Lee, “How Extreme Agility Put Zara Ahead in Fast Fashion,” *Financial Times*, December 9, 2019, https://www.ft.com/content/3f581046-cd7c-11e9-b018-ca4456540ea6 (accessed October 29, 2020); “The Secret of Zara’s Success: A Culture of Customer Co-Creation,” Martin Roll, blog, August 2018, https://martinroll.com/resources/articles/strategy/the-secret-of-zaras-success-a-culture-of-customer-co-creation/ (accessed October 29, 2020).

9 “The Story of Zipcar,” Zipcar, https://www.zipcar.com/about (accessed October 29, 2020).

10 “Design Partnerships,” Target, https://corporate.target.com/article/tag/1927/Design-Partnerships (accessed October 29, 2020).

11 Parija Kavilanz, “This Startup Is Making Glasses Kids Will Actually Want to Wear,” *CNN*, January 23, 2020 https://www.cnn.com/2019/01/23/success/pair-eyewear-childrens-glasses/index.html (accessed October 29, 2020); Adam Blair, “Pair Eyewear Focuses on Fun and Fashion to Multiply Sales of Kids’ Glasses,” *Retail TouchPoints,* February 4, 2020, https://retailtouchpoints.com/topics/customer-experience/pair-eyewear-focuses-on-fun-and-fashion-to-multiply-sales-of-kids-glasses (accessed October 30, 2020).

12 Jefferson Graham, “Samsung Hits a New Record with the Most Expensive Smartphone: $2,000,” *TechExplore,* September 1, 2020, https://techxplore.com/news/2020-09-samsung-expensive-smartphone.html (accessed February 22, 2021).

13 Sephora.com (accessed October 30, 2020); Parija Kavilanz, “No Testers, No Problem: Ulta and Sephora Have a New Take on ‘Try Before You Buy’,” *CNN,* June 18, 2020, https://www.cnn.com/2020/06/18/business/ulta-sephora-virtual-makeovers/index.html (accessed October 30, 2020).

14 Jacob Krol, “Office 365 Is Becoming Microsoft 365 with New Features for the Same Price,” *CNN,* March 30, 2020, https://www.cnn.com/2020/03/30/cnn-underscored/microsoft-365-pricing-office-outlook-word-excel/index.html (accessed November 1, 2020).

15 Amelia Lucas, “Powerade Is Launching 2 New Product Lines as Consumer Exercise Habits Change,” *CNBC,* January 16, 2020, https://www.cnbc.com/2020/01/16/powerade-is-launching-2-new-product-lines-as-exercise-habits-change.html (accessed November 2, 2020).

16 “Social Content Ratings,” Nielsen Social, https://www.nielsensocial.com/what-we-do/ (accessed November 3, 2020).

17 Ritash Pathak, “How Coca-Cola Uses Technology to Stay at the Top,” *Analytic Steps,* October 24, 2020, https://www.analyticssteps.com/blogs/how-coca-cola-uses-technology-stay-top (accessed November 3, 2020).

18 Peter Roeslier, “Consumers Find Influencers More Trustworthy Than Brands During the Pandemic,” *Beauty Packaging,* May 26, 2020, https://www.beautypackaging.com/contents/view_breaking-news/2020-05-26/consumers-find-influencers-more-trustworthy-than-brands-during-the-pandemic/ (accessed November 5, 2020).

19 Evelyn Cheng, “China’s Giant Middle Class Is Still Growing and Companies from Walmart to Startups Are Trying to Cash In,” *CNBC,* September 30, 2019, https://www.cnbc.com/2019/09/30/chinas-giant-middle-class-is-still-growing-and-companies-want-in.html (accessed November 6, 2020).

20 Based on information in CNBC, “How Starbucks Became an $80B Business,” *YouTube*, January 10, 2019, www.youtube.com/watch?v=XUBeH7VQaFY; Starbucks, “Starbucks Company Profile,” www.starbucks.com/about-us/company-information/starbucks-company-profile; Starbucks, “Company Information,” www.starbucks.com/about-us/company-information; Jennifer Warnick, “Five Things to Know About Starbucks (Online) Shareholders Meeting,” *Starbucks Stories & News*, March 18, 2020, https://stories.starbucks.com/stories/2020/five-things-to-know-about-starbucks-online-annual-meeting-of-shareholders; Kate Rogers, “Starbucks Is Speeding Up Innovation at its Seattle Research Hub,” *CNBC*, May 2, 2019, www.cnbc.com/2019/05/02/starbucks-is-speeding-up-innovation-at-its-seattle-research-hub.html; Sarah Whitten and Kate Rogers, “Starbucks Cuts Long-Term Earnings per Share Forecast; Shares Fall,” *CNBC*, December 13, 2018, https://www.cnbc.com/2018/12/13/starbucks-partners-with-uber-eats-to-deliver-to-customers.html.

Chapter 12

1 Based on information in Phil Wahba, “Petco Rebrands, Bans Shock Collars in Health and Wellness Push,” *Fortune,* October 7, 2020, www.fortune.com/2020/10/07/petco-rebrand-shock-collars-ban-pet-health-wellness; Rhian Hunt, “Petco May Be Heading for an IPO as a $6 Billion Company,” *The Motley Fool,* September 10, 2020, www.fool.com/investing/2020/09/10/petco-may-be-heading-for-an-ipo-as-a-6-billion-com; Petco, “Fact Sheets,” https://corporate.petco.com/fact-sheets.

2 Matt Reynolds, “Jif, Skippy Add Flexible, Squeezable Peanut Butter Pack Formats,” *Packaging World*, September 11, 2020, https://www.packworld.com/design/flexible-packaging/article/21174956/jif-skippy-add-flexible-squeezable-peanut-butter-pack-formats (accessed November 11, 2020).

3 Gillian Friedman, “Goodbye Tab: Coca-Cola Will Discontinue the Iconoic Soda,” *The New York Times,* October 16, 2020, https://www.nytimes.com/2020/10/16/business/coca-cola-tab.html (accessed November 12, 2020).

4 Procter & Gamble, https://us.pg.com/brands/ and https://www.pg.co.uk/brands/ (accessed February 15, 2021).

5 Eric Schroeder, “Panera Debuts Flatbread Pizza,” *Food Business News,* October 29, 2020, https://www.foodbusinessnews.net/articles/17179-panera-debuts-flatbread-pizza (accessed November 12, 2020).

6 Monica Watrous, “Inside Ferrara’s Transformation of Keebler Cookies,” *Food Business News,* July 30, 2020, https://www.foodbusinessnews.net/articles/16521-inside-ferraras-transformation-of-keebler-cookies (accessed November 12, 2020).

7 Eric Schroeder, “Hostess Innovates with New Snack Cake Flavors,” *Food Business News,* November 12, 2020, https://www.foodbusinessnews.net/articles/17291-hostess-innovates-with-new-snack-cake-flavors (accessed November 12, 2020).

8 John Bowker, “Bombardier Drops Iconic Learjet to Focus on Luxury Models,” *Bloomberg.com*, February 11, 2021, https://search.ebscohost.com.srv-proxy1.library.tamu.edu/login.aspx?direct=true&db=bsu&AN=148657829&site=ehost-live (accessed February 16, 2021).

9 Ashlee Vance and Brad Stone, “Air Taxi Startup Has a Working Prototype and a Fresh $100 Million,” *Business Week,* February 1, 2018, https://www.bloomberg.com/news/articles/2018-02-01/air-taxi-startup-joby-has-a-working-prototype-and-a-fresh-100m (accessed February 16, 2021); Jeff Sloan, “Joby Aviation Acquires Uber Elevate,” *Composites World,* December 18, 2020, https://www.compositesworld.com/news/joby-aviation-acquires-uber-elevate (accessed February 16, 2021).

10 Mark Wilson, “Dyson’s Latest Invention? A $500 Flat Iron That Won’t Fry Your Hair,” *Fast Company,* March 10, 2020, https://www.fastcompany.com/90474395/dysons-latest-invention-a-500-flat-iron-that-wont-fry-your-hair (accessed February 16, 2021).

11 “Brewing the American Dream,” Samuel Adams Brewing, *https://btad.samueladams.com/about (accessed February 15, 2021)*.

12 “Only a Dyson Works Like a Dyson: The Engineering Behind Dyson Vacuums,” *Dyson,* https://www.dyson.com/newsroom/overview/features/june-2020/only-a-dyson-works-like-a-dyson#:~:text=James%20Dyson%20started%20his%20journey,now%20on%20a%20global%20scale (accessed February 16, 2021).

13 Jonathan Maze, “Chick-Fil-A Is Testing a New Chicken Sandwich,” *Restaurant Business,* September 18, 2020, https://www.restaurantbusinessonline.com/food/chick-fil-testing-new-chicken-sandwich (accessed February 24, 2021).

14 Joe Maring, “Samsung Galaxy Note 7: Everything You Need to Know!,” *Android Central,* June 4, 2020, https://www.androidcentral.com/samsung-galaxy-note-7 (accessed February 16, 2021).

15 Phil Wahba, “Target’s Newish Athletic Line Is Now Its 10th Billion-Dollar Store Brand,” *Fortune,* February 8, 2021, https://fortune.com/2021/02/08/target-athletic-all-in-motion-billion-dollar-store-brand/ (accessed February 24, 2021).

16 Udo Kopka et al, “What Got Us Here Won’t Get Us There: A New Model for the Consumer Goods Industry,” McKinsey & Company, July 30, 2020, https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/what-got-us-here-wont-get-us-there-a-new-model-for-the-consumer-goods-industry (accessed February 16, 2021).

17 “Mohawk Group Furthers Execution of M&A Strategy Announcing Accretive Acquisition of Mueller, Purstream, Pohl Schmitt and Spiralizer E-Commerce Brands,” Globenewswire, press release, December 10, 2020, https://www.globenewswire.com/news-release/2020/12/01/2137922/0/en/Mohawk-Group-Furthers-Execution-of-M-A-Strategy-Announcing-Accretive-Acquisition-of-Mueller-Pursteam-Pohl-and-Schmitt-and-Spiralizer-E-Commerce-Brands.html (accessed February 17, 2021).

18 Emily Price, “Why Bud Light Gave Its New Hard Seltzer the Family Name,” *Fortune,* January 29, 2020, https://fortune.com/2020/01/29/bud-light-hard-seltzer/ (accessed February 24, 2021).

19 Miles Socha, “Louis Vuitton Expands In Tokyo with New Tower, Café—and Chocolate Shop,” *WWD,* January 27, 2021, https://wwd.com/fashion-news/designer-luxury/louis-vuitton-chocolate-tokyo-ginza-exhibition1234711822-1234711822/ (accessed February 24, 2021).

20 Replenish, https://myreplenish.com/ (accessed February 24, 2021); CleanPath, https://mycleanpath.com/ (accessed February 24, 2021).

21 Stefanie Valentic, “How the Coca-Cola’s Recycled Bottle Redesign Is Progressing Sustainability Efforts,” *Waste 360*, February 9, 2021, https://www.waste360.com/sustainability/how-coca-cola-companys-recycled-bottle-redesign-progressing-sustainability-efforts (accessed February 24, 2021).

22 Pamela DeLoatch, “Survey: Packaging, Labeling Determine Whether a Shopper Buys a Product,” *FoodDive,* January 4, 2018, https://www.fooddive.com/news/survey-packaging-labeling-determine-whether-a-shopper-buys-a-product/513919/ (accessed February 24, 2021).

23 Neil Patel, “How Planet Fitness Capitalizes on the Casual Gym-Goer Despite Tough Times,” *The Motley Fool,* May 6, 2020, https://www.fool.com/investing/2020/05/06/how-planet-fitness-capitalizes-on-the-casual-gym-g.aspx (accessed February 25, 2021); Nathaniel Meyersohn, “Planet Fitness Is Winning by Charging $10 a Month,” *CNN*, January 12, 2018, https://money.cnn.com/2018/01/12/news/companies/planet-fitness/index.html?iid=hp-stack-dom (accessed February 25, 2021).

24 Amy Feldman, “Why One Entrepreneur Thinks Millions of Americans Will Spend $25 on His Personalized Shampoo,” *Forbes*, August 18, 2020, https://www.forbes.com/sites/amyfeldman/2020/08/18/why-one-entrepreneur-thinks-millions-of-americans-will-spend-25-on-his-personalized-shampoo/?sh=7de284829615 (accessed February 25, 2021).

25 Bill Shaikin, “What Does the Dodgers’ Dynamic Pricing Schedule Mean for Fans? A Seat That Costs $33 One Day Will Cost $80 Another Day,” *Los Angeles Times*, January 26, 2018, https://www.latimes.com/sports/dodgers/la-sp-dodgers-tickets-20180126-story.html (accessed February 26, 2021).

26 Based on information in TimesTicking, “The History of the Shinola Watch Company,” *YouTube,* July 16, 2020, www.youtube.com/watch?v=qxHYgS8lxEE; Jack Roskopp, “What Is Shinola and Why Did It Get a Shoutout During the Oscars?” *Click Orlando,* February 25, 2019, www.clickorlando.com/entertainment/2019/02/25/what-is-shinola-and-why-did-it-get-a-shoutout-during-the-oscars; Shinola, “Our Story,” www.shinola.com/our-story.html; Randy Wimbley, “Shinola Lays off Employees, Plans to Outsource Some Operations,” *Fox 2 Detroit,* www.fox2detroit.com/news/shinola-lays-off-employees-plans-to-outsource-some-operations.

Chapter 13

1 Based on information in Sarah Nassauer, “Walmart to Combine Online and Store Product-Buying Teams,” *The Wall Street Journal*, February 25, 2020, www.wsj.com/articles/walmart-to-combine-online-and-store-product-buying-teams-11582643932; Walmart, “About Us,” https://corporate

.walmart.com/our-story; Ben Unglesbee, “Walmart Cuts Corporate Jobs as It Focuses on Omnichannel Push,” *Retail Dive*, July 31, 2020, www.retaildive.com/news/walmart-cuts-corporate-jobs-as-it-focuses-on-omnichannel-push/582691.

2 Pat Reynolds, “P&G Greatly Expands Eco-Box Portfolio,” *Packaging World,* April 22, 2020, https://www.packworld.com/issues/article/21129929/pg-greatly-expands-ecobox-portfolio (accessed March 3, 2021).

3 Blake Morgan, “After a Bruising Year, Logistics and Supply Chains Are Ripe for Technology Disruption,” *Tech Exec,* February 22, 2021, https://techexec.com.au/?p=2774 (accessed March 3, 2021).

4 Fareeha Ali, “US Ecommerce Grows 44.0% in 2020,” *Digital Commerce 360,* January 29, 2021, https://www.digitalcommerce360.com/article/us-ecommerce-sales/ (accessed March 4, 2021); Bureau of Labor Statistics, “Industries at a Glance,” https://www.bls.gov/iag/tgs/iag44-45.htm (accessed March 4, 2021).

5 “FTI Consulting Projects U.S. Online Retail Sales Growth to Increase 25% in 2020,” FTI Consulting, press release, October 13, 2020, https://www.fticonsulting.com/about/newsroom/press-releases/fti-consulting-projects-us-online-retail-sales-growth-to-increase-25-in-2020 (accessed March 4, 2021).

6 Fareeha Ali, “Nordstrom’s Ecommerce Sales Represent 61% of Revenue in Q2,” *Digital Commerce 360,* August 31, 2020, https://www.digitalcommerce360.com/2020/08/31/nordstroms-ecommerce-sales-represent-61-of-revenue-in-q2/ (accessed March 4, 2021).

7 Caroline Jansen, “Casper Expands Physical Presence Through Tie-Up with Sam’s Club,” *Retail Dive,* August 10, 2020, https://www.retaildive.com/news/casper-expands-physical-presence-through-tie-up-with-sams-club/583220/ (accessed March 4, 2021).

8 “Fact Sheets,” *National Association of Convenience Stores*, https://www.convenience.org/Research/FactSheets (accessed March 4, 2021).

9 “About Direct Selling,” *Direct Selling*, https://directselling.org/about-direct-selling/ (accessed March 4, 2021).

10 *Do Not Call*, “https://www.donotcall.gov” (accessed March 4, 2021); Simon van Zuylen-Wood, “How Robocallers Outwitted the Government and Completely Wrecked the Do Not Call List,” *The Washington Post*, January 11, 2018, https://www.washingtonpost.com/lifestyle/magazine/how-robo-call-moguls-outwitted-the-government-and-completely-wrecked-the-do-not-call-list/2018/01/09/52c769b6-df7a-11e7-bbd0-9dfb2e37492a_story.html?utm_term=.949f2ead04a5 (accessed March 4, 2021).

11 Dan Gilmore, “State of the Logistics Union 2020,” *Supply Chain Digest,* June 25, 2020, https://www.scdigest.com/firstthoughts/20-06-25_State_of_Logistics_Report.php?cid=16943 (accessed March 4, 2021).

12 Ibid.

13 “Building, Executing, and Measuring an Integrated Marketing Campaign,” *Marketing Dive,* April 28, 2020, https://www.marketingdive.com/spons/building-executing-and-measuring-an-integrated-marketing-campaign/576440/ (accessed March 5, 2021).

14 Jack Neff, “Marketers of the Year No. 7: E.L.F.,” *AdAge,* December 7, 2020, https://adage.com/article/special-report-marketers-year/marketers-year-no-7-elf/2296881 (accessed March 8, 2021).

15 “U.S. Measured-Media Spending by Medium in 2019,” *Advertising Age Marketing Fact Pack 2021*, December 21, 2020, p. 5.

16 National Association of Realtors, “NAR’s ‘That’s Who We R’ Advertising Campaign Highlights How Realtors® Open Doors to Opportunity for Their Clients and the Communities They Serve,” press release, February 16, 2021, https://www.nar.realtor/newsroom/nars-thats-who-we-r-advertising-campaign-highlights-how-realtors-open-doors-to-opportunity-for (accessed March 5, 2021).

17 Jessica Wohl, “Burger King Brings Humor to These ‘Confusing Times’ in Impossible Burger Radio Spots,” *AdAge,* March 4, 2021, https://adage.com/article/cmo-strategy/burger-king-brings-humor-these-confusing-times-impossible-whopper-radio-spots/2319311 (accessed March 8, 2021).

18 Jessica Wohl, “McDonald’s Launches a New Campaign to Promote Free Food for First Responders,” *AdAge,* April 21, 2021, https://adage.com/article/cmo-strategy/mcdonalds-launches-new-campaign-promote-free-food-first-responders/2251106 (accessed March 8, 2021).

19 “AdAge World’s Largest U.S. Advertisers: 25 Biggest Spenders,” *AdAge Marketing Fact Pack 2021*, December 21, 2020, p. 6.

20 “We’re Disrupting the Way the World Sees Deals,” RetailMeNot, https://www.retailmenot.com/corp/about/ (accessed March 9, 2021).

21 Mary Hanbury, “People Are Obsessed with Costco’s Free Samples—But It’s Actually a Brilliant Business Strategy,” *Business Insider,* March 21, 2018, https://www.businessinsider.com/costco-free-samples-strategy-2018-3 (accessed March 9, 2021).

22 “sandiegozoo,” TikTok, https://www.tiktok.com/@sandiegozoo?source=h5_m&is_copy_url=1&is_from_webapp=v2 (accessed March 9, 2021).

23 Sophie Cole, “How a Strong Brand Tone of Voice Can Help You Recover from Controversy,” Stratton Craig, blog, July 10, 2020, https://www.strattoncraig.com/blog/recover-bad-reputation-rebuild-brand/ (accessed March 4, 2021); Dan Tynan, “How to Survive a Public Brand Scandal and Recover Customers’ Trust,” Adweek, March 11, 2018, https://www.adweek.com/digital/how-to-survive-a-public-brand-scandal-and-recover-customers-trust/ (accessed March 9, 2021).

24 Based on information in CNBC Make It, “How Casper Became A $1 Billion Mattress Start-Up,” YouTube, April 9, 2019, www.youtube.com/watch?v=yEFeDP9goZU; “Casper’s IPO is Officially a Disaster,” *CNN*, February 5, 2020, www.cnn.com/2020/02/05/investing/casper-ipo-share-price/index.html; “Casper, the Mattress Start-Up, Goes Through With Lackluster I.P.O,” *The New York Times*, February 6, 2020, www.nytimes.com/2020/02/06/technology/casper-ipo.html; Clare Roth, “Mattress Unicorn Casper Accused of Misleading Investors With IPO,” *Bloomberg*, June 27, 2020, www.bloomberg.com/news/articles/2020-06-27/mattress-unicorn-casper-accused-of-misleading-investors-with-ipo.

25 Based on information from Simon Mainwaring, “Purpose at Work: Graeter’s Ice Cream’s Ingredients Success,” *Forbes,* September 22, 2020, https://www.forbes.com/sites/simonmainwaring/2020/09/22/purpose-at-work-graeters-ice-creams-ingredients-success/?sh=15595e6c406a; Amber Hunt, “As Graeter’s Celebrates 150 Years, Its Longevity Can Be Traced to One Stubborn Woman,” *Cincinnati Enquirer,* July 16, 2020, https://www.cincinnati.com/story/news/2020/07/16/graeters-celebrates-150-years-its-success-can-traced-one-woman/5393959002/; Kathie Canning, “Graeter’s Ice Cream Plant Is Different by Design,” *Dairy Foods,* October 4, 2019 https://www.dairyfoods.com/articles/93878-graeters-ice-cream-plant-is-different-by-design; “Graeter’s Manufacturing Co.,” Dun & Bradstreet, https://www.dnb.com/business-directory/company-profiles.graeters_manufacturing_co.34b374200d30ae53cea748c5da0fe772.html (accessed March 15, 2021); Alexander Coolidge, “Graeter’s Pitches Its Products Nationwide,” *Cincinnati Enquirer,* June 20, 2014, https://www.cincinnati.com/story/money/2014/06/18/graeters-pitches-product-nationwide/10820875/; Kimberly L. Jackson, “Graeter’s Premium Chocolate Chip Ice Creams Land at Stop & Shop,” *Newark Star-Ledger (NJ)*, April 4, 2012, https://www.nj.com/homegarden/2012/04/graeters_premium_ice_cream_lan.html; “Graeter’s Ice Cream Debuts in Bay Area,” *Tampa Bay Times (St. Petersburg, FL)*, January 10, 2012, p. 4B; Jim Carper, “Graeter’s Runs a Hands-on Ice Cream Plant,” *Dairy Foods*, August 2011, pp. 36+; Jim Carper, “The Greater Good,” *Dairy Foods*, August 2011, pp. 95+; “Graeter’s Unveils New ‘Mystery Flavor’,” *Dayton Daily News*, March 29, 2012, www.daytondailynews.com; Bob Driehaus, “A Cincinnati Ice Cream Maker Aims Big,” *The New York Times*, September 11, 2010, www.nytimes.com; Lucy May, “Graeter’s Northern Kentucky Franchisee Puts Stores on the Block,” *Business Courier*, August 6, 2010, https://cincinnati.bizjournals.com; www.graeters.com; interviews with company staff and Cengage videos about Graeter’s.

Chapter 14

1 Based on information in Netflix Research, “Personalization & Search,” https://research.netflix.com/business-area/personalization-and-search; Jeremy Bowman, “Netflix Is Killing the Competition in This One Key Category,” *The Motley Fool*, September 15, 2020, www.fool.com/investing/2020/09/15/netflix-is-killing-the-competition-in-this-one-key; Tara Lachapelle, “Netflix Investors, We Need to Talk About Churn,” *Bloomberg*, January 19, 2021, www.bloomberg.com/opinion/articles/2021-01-19/netflix-hbo-max-disney-face-reckoning-with-churn.

2 Social Media Fact Sheet,” Pew Research, https://www.pewresearch.org/internet/chart/how-often-americans-are-using-social-media/ (accessed April 9, 2021).

3 Brent Barnhart, “Social Media Demographics to Inform Your Brand’s Strategy in 2021,” Sprout Social, March 9, 2021, https://sproutsocial.com/insights/new-social-media-demographics/.

4 “2020 National Customer Rage Study,” Customer Care Measurement and Consulting, https://www.customercaremc.com/insights/national-customer-rage-study/2020-national-customer-rage-study/ (accessed November 27, 2020).

5. "The Top 10 Super Bowl 2020 Commercials by Digital Share of Voice," Ad Age, https://adage.com/article/special-report-super-bowl/top-10-super-bowl-2020-commercials-digital-share-voice/2233646 (accessed February 3, 2020).
6. Rosie Murphy, "Local Consumer Review Survey 2020," BrightLocal, https://www.brightlocal.com/research/local-consumer-review-survey/ (accessed December 9, 2020).
7. Ibid.
8. The Wyndham Hotel website, https://www.wyndhamhotels.com/ (accessed March 12, 2021).
9. Kiva, www.kiva.org (accessed March 13, 2021).
10. "PwC Global Crisis Survey," PricewaterhouseCoopers, https://www.pwc.com/ (accessed February 22, 2021).
11. Nina Solis, "How to Respond to a Negative Online Review," Broadly, https://broadly.com (accessed February 27, 2021).
12. "Generation Z News," *Business Insider*, https://www.businessinsider.com/generation-z#learn-more (accessed February 20, 2021).
13. Kavya Ravi, "6 Ways Nike Built a Strong Brand on Social Media," Unmetric, https://blog.unmetric.com/nike-social-media (accessed April 25, 2018).
14. Ibid.
15. Alexander Santo, "The Ultimate List of Marketing Spend Statistics," Brafton, https://www.brafton.com/blog/content-marketing/the-ultimate-list-of-marketing-spend-statistics-for-2019-infographic/ (accessed February 20, 2019).
16. "More Smiles in 2020: Lay's Kicks Off Search for People Creating Joy Across the Country; Unveils Three New Flavors to Smile About," Frito-Lay, https://www.fritolay.com/more-smiles-in-2020-lays-kicks-off-search-for-people-creating-joy-across-the-country-unveils-three (accessed January 8, 2020).
17. "Lego Ideas," The Lego Group, March 12, 2021, https://ideas.lego.com (accessed March 12, 2021).
18. LinkedIn, www.linkedin.com (accessed March 3, 2021).
19. Melissa Barker, Donald Barker, Nicholas Bormann, and Krista E. Neher. *Social Media Marketing: A Strategic Approach* (Mason, OH: Cengage Publishing, 2017).
20. Emily Heaslip, "9 Wildly Successful Crowdfunded Startups," U.S. Chamber of Commerce, https://www.uschamber.com/co/start/startup/successful-crowdfunded-startups (accessed October 1, 2019).
21. SAP, https://www.sap.com/community.html (accessed March 5, 2021).
22. Daniela Coppola, "E-Commerce in the United States—Statistics & Facts," Statista.com, https://www.statista.com/statistics/272391/us-retail-e-commerce-sales-forecast/ (accessed February 20, 2021).
23. Jullia Andjelic, "47 Mobile Marketing Statistics to Transform Your Business," Smallbizgenius, https://www.smallbizgenius.net/by-the-numbers/mobile-marketing-statistics/#:~:text=%20Top%20Mobile%20Marketing%20Statistics%20%201%20Today%2C,expected%20to%20reach%2063.4%25%20of%20the...%20More%20 (accessed January 26, 2021).
24. "Quarterly Retail E-Commerce Sales," *U.S. Census Bureau News*, https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf (accessed February 19, 2021).
25. Natalie Colarossi, "Online Black Friday Shoppers Increase Nearly 45 Percent Amid COVID-19 Pandemic," *Newsweek*, https://www.newsweek.com/online-black-friday-shoppers-increase-nearly-45-percent-amid-covid-19-pandemic-1551591 (accessed December 1, 2020).
26. Internet World Stats, https://www.internetworldstats.com/ (accessed March 16, 2021).
27. Ibid.
28. Brent Barnhart, "Social Media Demographics to Inform Your Brand's Strategy in 2021," Sprout Social, https://sproutsocial.com/insights/new-social-media-demographics/ (March 9, 2021).
29. Eugene Lee, "Can My Employer Monitor My Web Surfing or Emails at work? (2020)," California Labor and Employer Law, https://calaborlaw.com/can-my-employer-monitor-my-web-surfing-or-emails-at-work/ (accessed February 25, 2021).
30. Jacquelyn Bulao, "How Many Cyber Attacks Happen Per Day in 2020?," TechJury, https://techjury.net/blog/how-many-cyber-attacks-per-day/ (accessed July 28, 2020).
31. "Seena Gressin, " Identity Theft Awareness Week Starts Today," Federal Trade Commission, https://www.consumer.ftc.gov/blog/2021/02/identity-theft-awareness-week-starts-today (accessed February 1, 2021).
32. Eugene Bekker, "2020 Data Breaches," IdentityForce, https://www.identityforce.com/blog/2020-data-breaches (accessed March 11, 2021).
33. Based on information in Melissa Repko, "Target Aims to Make Its Booming Online Business More Profitable With New Technology, Small Sort Centers," *CNBC*, May 20, 2020, www.cnbc.com/2020/05/20/heres-how-target-aims-to-make-its-booming-online-business-more-profitable.html; Jackie Crosby, "Target CEO: $7 Billion Investment in Stores and Technology Is Paying Off," *Star Tribune*, March 2, 2019, www.startribune.com/target-ceo-7-billion-investment-in-stores-and-technology-is-paying-off/506568732; Shelley E. Kohan, "Target's Big Investments, From Small-Format Stores To Digital, Prove Successful," *Forbes*, March 4, 2020, www.forbes.com/sites/shelleykohan/2020/03/04/targets-focus-on-employees-and-customers-delivers-revenue-growth-of-37-for-2019.

Chapter 15

1. Based on information in Derek Loosvelt, "Pros and Cons of Working for the Big 4 and Other Top Accounting Firms," *Vault*, March 20, 2019, www.vault.com/blogs/job-search/pros-and-cons-of-working-for-the-big-4-and-other-top-accounting-firms; KPMG, "Your Career," March 11, 2021, https://us-jobs.kpmg.com/careers/YourCareer; PwC, "Employee Benefits," March 11, 2021, www.pwc.com/us/en/careers/why-pwc/employee-benefits.html; Will Kenton, "The Big 4," Investopedia, January 7, 2021, www.investopedia.com/terms/b/bigfour.asp.
2. Wolf Richter, "Accounting Fraud & Freight Recession Topple Celadon, Largest Truckload-Carrier Bankruptcy In US History," Wolfstreet, https://wolfstreet.com/2019/12/09/accounting-fraud-freight-recession-topple-celadon-largest-truckload-carrier-bankruptcy-in-us-history/ (accessed February 18, 2021).
3. Matthew Heller, "Power Solutions Fined for Accounting Fraud," CFO, https://www.cfo.com/fraud/2020/09/power-solutions-fined-for-accounting-fraud/#:~:text=Power%20Solutions%20Fined%20for%20Accounting%20Fraud.%20The%20engine,million%20to%20meet%20its%20guidance%20and%20analysts%E2%80%99%20estimates (accessed September 25, 2020).
4. "Welcome to Sarbanes Oxley 101," Sarbanes Oxley 101, https://sarbanes-oxley-101.com/ (accessed February18, 2021).
5. *Occupational Outlook Handbook,* U.S. Bureau of Labor Statistics, https://www.bls.gov/ooh/business-and-financial/accountants-and-auditors.htm (accessed February 18, 2021).
6. Based on information in Oracle, "Oracle Cloud Economics," March 1, 2021, www.oracle.com/cloud/economics; Oracle, "Oracle Security, Identity, and Compliance," March 1, 2021, www.oracle.com/security; Oracle, "Oracle Corporate Facts," March 1, 2021, www.oracle.com/corporate/corporate-facts.html; Todd Bishop, "Oracle's Larry Ellison Looks to One-up Amazon, Offering Full Cloud Inside Customer Data Centers," *Geekwire*, July 9, 2020, www.geekwire.com/2020/oracles-larry-ellison-looks-one-amazon-offering-full-cloud-inside-customer-data-centers; Bob Evans, "Hello, IBM and Microsoft: Larry Ellison's Big Plans for Oracle Autonomous Database," *Cloud Wars*, September 16, 2019, https://cloudwars.co/oracle/hello-ibm-microsoft-larry-ellison-oracle-autonomous-database; Fox Business, "Oracle Database, Not Amazon Has Most of the World's Data: Larry Ellison," *YouTube*, October 25, 2018, https://www.youtube.com/watch?v=V5_k3xPH9Ko; Oracle, "Oracle Ups the Ante in Cloud with World's First Autonomous Operating System," September 16, 2019, www.oracle.com/corporate/pressrelease/oow19-oracle-autonomous-linux-091619.html; and Silicon Valley Historical Association, "Oracle," 2008, www.siliconvalleyhistorical.org/oracle-history.

Chapter 16

1. Based on information in Adam Levine-Weinberg, "Southwest Airlines Takes a Different Path Through the Pandemic," *The Motley Fool*, July 27, 2020, www.fool.com/investing/2020/07/27/southwest-airlines-takes-a-different-path-through.aspx; Southwest, "Southwest Corporate Fact Sheet," March 21, 2021, www.swamedia.com/pages/corporate-fact-sheet; "Southwest Airlines Reports Fourth Quarter and Annual 2020 Results," *PR Newswire*, January 28, 2021, www.prnewswire.com/news-releases/southwest-airlines-reports-fourth-quarter-and-annual-2020-results-301216824.html.
2. Priya Merchant, "Pivoting During the Pandemic: How These Businesses Succeeded," Entrepreneur, https://www.entrepreneur.com/article/362003 (accessed January 12, 2021).
3. The *Occupational Outlook Handbook,* U.S. Bureau of Labor Statistics, https://www.bls.gov/ooh/ (accessed March 1, 2021).
4. "Income Statement," Intel, https://www.intc.com/financial-info/income-statement (accessed March 9, 2021).

5 S. Lock, “McDonald’s: Ad Spend,” Statista.com, https://www.statista.com/statistics/286541/mcdonald-s-advertising-spending-worldwide/#:~:text=McDonald%27s%3A%20ad%20spend%202014-2019%20Published%20by%20S.%20Lock%2C,2019%2C%20down%20from%20476.8%20million%20the%20previous%20year (accessed March 1, 2021).

6 “Uber Agrees to Buy Food-Delivery Service Postmates for $2.65 Billion in Stock,” CNBC, https://www.cnbc.com/2020/07/06/uber-buys-postmates-food-delivery-service.html (accessed July 16, 2020).

7 Jonathan Stempel, “Warren Buffett Gives Up on Newspapers; Berkshire Sells Unit to Lee Enterprises,” Reuters, https://www.reuters.com/article/us-lee-enterprises-m-a-berkshire-idUSKBN1ZS1YB (accessed January 29, 2020).

8 Chris Isidore, “As JC Penney Exits Bankruptcy, Its Long-Term Outlook Remains Grim,” *CNN.com* https://www.cnn.com/2020/11/30/business/jcpenney-exits-bankruptcy-holiday-outlook/index.html (accessed November 30, 2020).

9 Laura Kim, Raynil Kumar, and Shaun O’Brien, “2020 Findings from the Diary of Consumer Payment Choice,” Federal Reserve Bank of San Francisco, https://www.frbsf.org/cash/publications/fed-notes/2020/july/2020-findings-from-the-diary-of-consumer-payment-choice/ (accessed July 31, 2020).

10 John Ulzheimer, “How Many Credit Cards Does the Average American Have?” CardRates.com, https://www.cardrates.com (accessed September 7, 2020).

11 Frank Vinluan, “Legend Biotech’s Upsized IPO Lands $424M for Multiple Myeloma Drug,” Xconomy, https://xconomy.com/new-york/2020/06/05/legend-biotechs-upsized-ipo-lands-424m-for-multiple-myeloma-drug/ (accessed June 5, 2020).

12 Procter & Gamble, https://s1.q4cdn.com/695946674/files/doc_financials/2020/ar/PG-2020-Annual-Report.pdf (accessed March 5, 2021).

13 Based on information in CNBC Television, “DoorDash Releases IPO Filing, Reports $149 Million Loss Through September,” *YouTube*, November 13, 2020, www.youtube.com/watch?v=v42sccX4XWc; Jessica Bursztynsky, “DoorDash Skyrockets in Market Debut, Closes up 85%,” *CNBC*, December 9, 2020, www.cnbc.com/2020/12/09/doordash-ipo-dash-trading-nyse.html; Megan Rose Dickey, “DoorDash Is Buying Caviar From Square in a Deal Worth $410 Million,” TechCrunch, August 1, 2019, www.techcrunch.com/2019/08/01/doordash-is-buying-caviar-from-square.

14 Based on information from the Graeter’s company website at www.graeter.com (accessed March 10, 2021); “Graeter’s Ice Cream,” Dun & Bradstreet, https://www.dnb.com/business-directory/top-results.html?term=graeters&page=1 (accessed February 11, 2021); “Graeter’s Ice Cream Plant Is Different by Design,” Dairy Foods, https://www.dairyfoods.com/articles/93878-graeters-ice-cream-plant-is-different-by-design (accessed February 12, 2021); Billy Kobin, “Graeter’s Ice Cream Takes Over Its Last Remaining Franchisee,” *Courier Journal,* https://www.courier-journal.com/story/money/companies/2018/09/24/graeters-ice-cream-buys-last-remaining-kentucky-franchise-stores/1415877002/, September 24, 2018; Jim Carper, “Graeter’s Runs a Hands-on Ice Cream Plant,” *Dairy Foods,* August 2011, p. 36; Jim Carper, “The Greater Good,” *Dairy Foods,* August 2011, p. 95; Bob Driehaus, “A Cincinnati Ice Cream Maker Aims Big,” *The New York Times,* September 11, 2010, www.nytimes.com; “Cincinnati Officials Help Dedicate New Graeter’s Plant,” Cincinnati Department of Community & Economic Development, https://choosecinci.com/news/cincinnati_officials_help_dedicate_new_graeters_plant (accessed October 25, 2010); and interviews with Graeter’s company executives, consultants, and staff and Cengage videos about Graeter’s.

Glossary

A

absolute advantage the ability to produce a specific product more efficiently than any other nation

accessory equipment standardized equipment used in a firm's production or office activities

account executive an individual, sometimes called a *stockbroker* or *registered representative,* who buys and sells securities for clients

accountability the obligation of a worker to accomplish an assigned job or task

accounting the process of systematically collecting, analyzing, and reporting financial information

accounting equation the basis for the accounting process: *Assets* = *Liabilities* + *Owners' equity*

ad hoc committee a committee created for a specific short-term purpose

administrative law the regulations created by government agencies established by legislative bodies

administrative manager a manager who is not associated with any specific functional area but who provides overall administrative guidance and leadership

advertising a paid nonpersonal message communicated to a select audience through a mass medium

advertising agency an independent firm that plans, produces, and places advertising for its clients

affirmative action program a plan designed to increase the number of employees from underrepresented groups at all levels within an organization

agency a business relationship in which one party, called the principal, appoints a second party called the agent, to act on its behalf

agency shop a workplace in which employees can choose not to join the union but must pay dues to the union anyway

agent an intermediary that expedites exchanges, represents a buyer or a seller, and often is hired permanently on a commission basis

alien corporation a corporation chartered by a foreign government and conducting business in the United States

analytic skills the ability to identify problems correctly, generate reasonable alternatives, and select the "best" alternatives to solve problems

analytical process a process in operations management in which raw materials are broken into different component parts

angel investor a wealthy investor who provides financial backing for small business start-ups or entrepreneurs

annual report a report distributed to stockholders and other interested parties that describes the firm's operating activities and its financial condition

appellate court a court that hears cases appealed from lower courts

arbitration the step in a grievance procedure in which a neutral third party hears the two sides of a dispute and renders a binding decision

asset allocation the process of spreading your money among several different types of investments to lessen risk

assets the resources that a business owns

audit an examination of a company's financial statements and the accounting practices that produced them

authority the power, within an organization, to accomplish an assigned job or task

autocratic leadership task-oriented leadership style in which workers are told what to do and how to accomplish it without having a say in the decision-making process

automation the total or near-total use of machines to do work

automobile liability insurance insurance that covers financial losses resulting from injuries or damage caused by the insured vehicle

B

balance of payments the total flow of money into a country minus the total flow of money out of that country over a specified period of time

balance of trade the total value of a nation's exports minus the total value of its imports over a specified period of time

balance sheet (or **statement of financial position)** a summary of the dollar amounts of a firm's assets, liabilities, and owners' equity accounts at the end of a specific accounting period

banker's acceptance a written order for a bank to pay a third party a stated amount of money on a specific date

bankruptcy a legal procedure designed both to protect an individual or business that cannot meet its financial obligations and to protect the creditors involved

bargaining unit the specific group of employees represented by a union

behavior modification a systematic program of reinforcement to encourage desirable behavior

beneficiary person or organization named in a life insurance policy as a recipient of the proceeds of that policy on the death of the insured

binding contract an agreement that requires an intermediary to purchase products from a particular supplier, not from the supplier's competitors

blog a website that allows a company to share information to increase the customer's knowledge about its products and services, and to build trust

blue-chip stock the stock of highly regarded corporations

board of directors the top governing body of a corporation, the members of which are elected by the stockholders

bond indenture a legal document that details all the conditions relating to a bond issue

boycott a refusal to do business with a particular firm

boycott in restraint of trade an agreement between businesses not to sell or buy from a particular entity

brand a name, term, symbol, design, or any combination of these that identifies a seller's products as distinct from those of other sellers

brand equity marketing and financial value associated with a brand's strength in a market

brand extension using an existing brand to brand a new product in a different product category

brand loyalty extent to which a customer is favorable toward buying a specific brand

brand mark the part of a brand that is a symbol or distinctive design

brand name the part of a brand that can be spoken

breach of contract the failure of one party to fulfill the terms of a contract when there is no legal reason for that failure

breakeven quantity the number of units that must be sold for the total revenue (from all units sold) to equal the total cost (of all units sold)

broker an intermediary that specializes in a particular commodity, represents either a buyer or a seller, and is likely to be hired on a temporary basis

budget a financial statement that projects income, expenditures, or both over a specified future period

bundle pricing packaging together two or more complementary products and selling them for a single price

business the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs

business buying behavior the purchasing of products by producers, resellers, governmental units, and institutions

business cycle the recurrence of periods of growth and recession in a nation's economic activity

business ethics the application of moral standards to business situations

business interruption insurance insurance protection for a business whose operations are interrupted because of a fire, storm, or other natural disaster

business model a model that represents a group of common characteristics and methods of doing business to generate sales revenues and reduce expenses

business plan a carefully constructed guide for the person starting a business

business product a product bought for resale, for making other products, or for use in a firm's operations

business service an intangible product that an organization uses in its operations

business-to-business (or **B2B) model** a model used by firms that conduct business with other businesses

business-to-consumer (or **B2C) model** a model used by firms that focus on conducting business with individual consumers

buying allowance a temporary price reduction to resellers for purchasing specified quantities of a product

buying behavior the decisions and actions of people involved in buying and using products

buying long buying a stock with the expectation that it will increase in value and then can be sold at a profit

C

capacity the number of products or services that an organization can produce in a given time

capital budget a financial statement that estimates a firm's expenditures for major assets and its long-term financing needs

capital-intensive technology a process in which machines and equipment do most of the work

capitalism an economic system in which individuals own and operate the majority of businesses that provide goods and services

captioned photograph a picture accompanied by a brief explanation

captive pricing pricing the basic product in a product line low, but pricing related items at a higher level

carrier a firm that offers transportation services

cash budget a financial statement that estimates cash receipts and cash expenditures over a specified period

cash flow the movement of money into and out of an organization

cash surrender value the amount payable to the holder of a whole life insurance policy if the policy is canceled

catalog marketing a type of marketing in which an organization provides a catalog from which customers make selections and place orders by mail, telephone, or the internet

category killer a very large specialty store that concentrates on a single product line and competes on the basis of low prices and product availability

caveat emptor a Latin phrase meaning "let the buyer beware"

centralized organization an organization that systematically works to concentrate authority at the upper levels of the organization

certificate of deposit (CD) a document stating that the bank will pay the depositor a guaranteed interest rate on money left on deposit for a specified period of time

certified public accountant (CPA) an individual who has met state requirements for accounting education and experience and has passed a rigorous accounting examination

chain of command the line of authority that extends from the highest to the lowest levels of an organization

chain retailer a company that operates more than one retail outlet

charismatic leadership personality-dependent leadership style

closed corporation (sometimes referred to as a private corporation) is a corporation whose stock is owned by relatively few people and is not sold to the general public

closed-end fund a type of mutual fund in which the sponsoring investment company sells shares in the fund to investors only when the fund is originally organized

closed shop a workplace in which workers must join the union before they are hired; outlawed by the Taft-Hartley Act

cloud computing a type of computer usage in which services stored on the internet are provided to users on a temporary basis

code of ethics a guide to acceptable and ethical behavior as defined by the organization

coinsurance clause a part of a fire insurance policy that requires the policyholder to purchase coverage at least equal to a specified percentage of the replacement cost of the property to obtain full reimbursement for losses

collateral real estate or property pledged as security for a loan

collective bargaining the process of negotiating a labor contract with management

command economy an economic system in which the government decides *what* goods and services will be produced, *how* they will be produced, *for whom* available goods and services will be produced, and *who* owns and controls the major factors of production

commercial paper a short-term promissory note issued by a large corporation

commission a payment that is a percentage of sales revenue

common law the body of law created by court decisions rendered by judges; also known as case law or judicial law

common stock the most basic form of corporate ownership and whose owners may vote on corporate policies

communication skills the ability to speak, listen, and write effectively

community of interests a situation in which one firm acquires a competing firm to reduce competition between the two

community shopping center a planned shopping center that includes one or two department stores and some specialty stores, along with convenience stores

comparative advantage the ability to produce a specific product more efficiently than any other product

comparison discounting setting a price at a specific level and comparing it with a higher price

compensation the payment employees receive in return for their labor

compensation system the policies and strategies that determine employee compensation

competition rivalry among businesses for sales to potential customers

component part an item that becomes part of a physical product and is either a finished item ready for assembly or a product that needs little processing before assembly

compressed workweek allows employees to work a 40-hour work week in four days instead of five

computer-aided design (CAD) the use of computers to aid in the development of products

computer-aided manufacturing (CAM) the use of software and computers to plan and control manufacturing processes

computer-integrated manufacturing (CIM) a computer system that not only helps to design products but also controls the machinery needed to produce the finished product

conceptual skills the ability to think in abstract terms

conflict of interest when businesspeople take advantage of a situation for their own personal interest rather than for the employer's interest

consideration the value or benefit that one party to a contract furnishes to the other party

consumer buying behavior the purchasing of products for personal or household use, not for business purposes

consumer price index (CPI) a monthly index that measures the changes in prices of a fixed basket of goods purchased by a typical consumer in an urban area

consumer products goods and services purchased by individuals for personal consumption

consumer sales promotion method a sales promotion method designed to attract consumers to particular retail stores and to motivate them to purchase certain new or established products

consumerism all activities undertaken to protect the rights of consumers

contingency plan a plan that outlines alternative courses of action that may be taken if an organization's other plans are disrupted or become ineffective

continuous process a manufacturing process in which a firm produces the same product(s) over a long period of time

contract a legally enforceable agreement between two or more competent parties who promise to do or not to do a particular thing

contract manufacturing an arrangement in which one firm contracts with another business, often in another country, to manufacture products or product components to its specifications

controlling the process of evaluating and regulating ongoing activities to ensure that goals are achieved

convenience product a relatively inexpensive, frequently purchased item for which buyers want to exert only minimal effort

convenience store a small food store that sells a limited variety of products but remains open well beyond normal business hours

convertible bond a bond that can be exchanged, at the owner's option, for a specified number of shares of the corporation's common stock

cookie a small piece of software sent by a website that tracks an individual's internet use

cooperative advertising an arrangement whereby a manufacturer agrees to pay a certain amount of a retailer's media cost for advertising the manufacturer's products

copyright the exclusive right to publish, perform, copy, or sell an original work

core competencies approaches and processes that a company performs well that may give it an advantage over its competitors

corporate bond a corporation's written pledge that it will repay a specified amount of money with interest

corporate citizenship adopting a strategic approach to fulfilling economic, ethical, environmental, and social responsibilities

corporate officers the chairperson of the board, president, executive vice presidents, corporate secretary, treasurer, and any other top executive appointed by the board of directors

corporation (sometimes referred to as a *regular* or a *C corporation*) an artificial person created by law with most of the legal rights of a real person

cost of goods sold the dollar amount equal to beginning inventory *plus* net purchases *less* ending inventory

countertrade an international barter transaction

coupon reduces the retail price of a particular item by a stated amount at the time of purchase

court of limited jurisdiction a court that hears only specific types of cases

court of original jurisdiction the first court to recognize and hear testimony in a legal action

craft union an organization of skilled workers in a single craft or trade

creative selling selling products to new customers and increasing sales to current customers

crime a violation of a public law

cross-functional team a team of individuals with varying specialties, expertise, and skills who are brought together to achieve a common task

crowdfunding a method of raising money to fund a project for a business, a nonprofit organization, or an individual

crowdsourcing outsourcing tasks to a group of people in order to tap into the ideas of the crowd

cultural (or **workplace) diversity** a system that recognizes and respects the differences among people because of their age, race, ethnicity, gender, sexual orientation, and ability

currency devaluation the reduction of the value of a nation's currency relative to the currencies of other countries

current assets assets that can be converted quickly into cash or that will be used in one year or less

current liabilities debts that will be repaid in one year or less

current ratio a financial ratio computed by dividing current assets by current liabilities

customary pricing pricing on the basis of tradition

customer lifetime value a measure of a customer's worth (sales minus costs) to a business over one's lifetime

customer relationship management (CRM) using information about customers to create marketing strategies that develop and sustain desirable customer relationships

customs (or **import) duty** a tax on a foreign product entering a country

D

damages a monetary settlement awarded to a party injured through a breach of contract

data numerical or verbal descriptions that usually result from some sort of measurement

data mining the practice of searching through data records looking for useful information

data processing the transformation of data into a form that is useful for a specific purpose

database a single collection of data and information stored in one place that can be used by people throughout an organization to make decisions

debenture bond a bond backed only by the reputation of the issuing corporation

debit card a card that electronically subtracts the amount of a purchase from a customer's bank account at the moment the purchase is made

debt capital borrowed money obtained through loans of various types

decentralized organization an organization in which management consciously attempts to spread authority widely across various organization levels

decision making the act of choosing one alternative from a set of alternatives

decision-support system (DSS) a type of software program that provides relevant data and information to help a firm's employees make decisions

deed a written document by which the ownership of real property is transferred from one person or organization to another

deflation a general decrease in the level of prices

delegation assigning part of a manager's work and power to other workers

demand the quantity of a product that buyers are willing to purchase at each of various prices

department store a retail store that (1) employs 25 or more persons and (2) sells at least home furnishings, appliances, family apparel, and household linens and dry goods, each in a different part of the store

departmentalization the process of grouping jobs into manageable units

departmentalization by customer grouping activities according to the needs of various customer populations

departmentalization by function grouping jobs that relate to the same organizational activity

departmentalization by location grouping activities according to the defined geographic area in which they are performed

departmentalization by product grouping activities related to a particular product or service

depreciation the process of apportioning the cost of a fixed asset over the period during which it will be used

depression a severe recession that lasts longer than a typical recession and has a larger decline in business activity when compared to a recession

deregulation the process of removing existing government regulations, forgoing proposed regulations, or reducing the rate at which new regulations are enacted

design planning the development of a plan for converting an idea into an actual product or service

digital distribution delivering content through the internet to a computer or other device

direct marketing the use of the telephone, internet, and nonpersonal media to introduce products to customers, who then can purchase them via mail, telephone, or the internet

direct-response marketing a type of marketing in which a retailer advertises a product and makes it available through mail, telephone, or online orders

direct selling the marketing of products to customers through face-to-face sales presentations at home or in the workplace

directing the combined processes of leading and motivating

discharge by mutual assent termination of a contract by mutual agreement of all parties

discount a deduction from the price of an item

discount store a self-service general-merchandise outlet that sells products at lower-than-usual prices

discretionary income disposable income *less* savings and expenditures on food, clothing, and housing

disposable income personal income *less* all personal taxes

distribution channel (or **marketing channel)** a sequence of marketing organizations that directs a product from the producer to the ultimate user

dividend a distribution of earnings to the stockholders of a corporation

domestic corporation a corporation in the state in which it is incorporated

domestic system a method of manufacturing in which an entrepreneur distributes raw materials to various homes, where families process them into finished goods to be offered for sale by the entrepreneur

double-entry bookkeeping system a system in which each financial transaction is recorded as two separate accounting entries to maintain the balance shown in the accounting equation

Dow Jones Industrial Average an average of 30 leading U.S. corporations that reflect the U.S. stock market as a whole

downsizing eliminating positions

dumping exportation of large quantities of a product at a price lower than that of the same product in the home market

E

e-business (or **electronic business)** the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs through the facilities available on the internet

e-commerce a part of e-business and usually refers only to buying and selling activities conducted online

economic community an organization of nations formed to promote the free movement of resources and products among its members and to create common economic policies

economic model of social responsibility the view that society will benefit most when business is left alone to produce and market profitable products that society needs

economics the study of how wealth is created and distributed

economy the way in which people deal with the creation and distribution of wealth

electronic funds transfer (EFT) system a means of performing financial transactions through a computer terminal

embargo a complete halt to trading with a particular nation or in a particular product

employee benefit a reward in addition to regular compensation that is provided indirectly to employees

employee ownership a situation in which employees own the company they work for by virtue of being stockholders

employee training the process of teaching operations and technical employees how to do their present jobs more effectively and efficiently

empowerment making employees more involved in their jobs by increasing their participation in decision making

endorsement the payee's signature on the back of a negotiable instrument

endowment life insurance life insurance that provides protection and guarantees the payment of a stated amount to the policyholder after a specified number of years

entrepreneur a person who risks time, effort, and money to start and operate a business

Equal Employment Opportunity Commission (EEOC) a government agency with the power to investigate complaints of employment discrimination and the power to sue firms that practice it

equity capital money received from the owners or from the sale of shares of ownership in a business

equity theory a theory of motivation based on the premise that people are motivated to obtain and preserve equitable treatment for themselves

ethics the study of right and wrong and of the morality of the choices individuals make

everyday low prices (EDLPs) setting a low price for products on a consistent basis

exchange control a restriction on the amount of a particular foreign currency that can be purchased or sold

exchange-traded fund (ETF) a fund that generally invests in the stocks or other securities contained in a specific stock or securities index

excise tax a tax on the manufacture or sale of a particular domestic product

exclusive distribution the use of only a single retail outlet for a product in a large geographic area

expectancy theory a model of motivation based on the assumption that motivation depends on how much we want something and on how likely we think we are to get it

expense ratio all the different management fees; 12b-1 fees, if any; and additional operating costs for a specific fund

expert system a type of computer program that uses artificial intelligence to imitate a human's ability to think

Export-Import Bank of the United States an independent agency of the U.S. government whose function is to assist in financing the exports of American firms

exporting selling and shipping raw materials or products to other nations

express warranty a written explanation of the producer's responsibilities in the event that a product is found to be defective or otherwise unsatisfactory

extended coverage insurance protection against damage caused by wind, hail, explosion, vandalism, riots or civil commotion, falling aircraft, and smoke

F

factor a firm that specializes in buying other firms' accounts receivables

factors of production inputs and resources used to produce goods and services

factory system a system of manufacturing in which all the materials, machinery, and workers required to manufacture a product are assembled in one place

family branding the strategy in which a firm uses the same brand for all or most of its products

family of funds a group of mutual funds managed by one investment company

feature article a piece (of up to 3,000 words) prepared by an organization for inclusion in a particular publication

federal deficit a shortfall created when the federal government spends more in a fiscal year than it receives

Federal Trade Commission (FTC) a five-member committee charged with the responsibility of investigating illegal trade practices and enforcing antitrust laws

fidelity bond an insurance policy that protects a business from theft, forgery, or embezzlement by its employees

financial accounting generates financial statements and reports for interested people outside an organization

financial leverage the use of borrowed funds to increase the return on owners' equity

financial management all the activities concerned with obtaining money and using it effectively

financial manager a manager who is primarily responsible for an organization's financial resources

financial plan a plan for obtaining and using the money needed to implement an organization's goals and objectives

financial planner an individual who has had comprehensive training in investments, insurance, taxation, retirement planning, and estate planning and has passed a rigorous examination

financial ratio a number that shows the relationship between two elements of a firm's financial statements

fire insurance insurance that covers losses due to fire

first-line manager a manager who coordinates and supervises the activities of operating employees

fiscal policy government influence on the amount of savings and expenditures; accomplished by altering the tax structure and by changing the levels of government spending

fixed assets assets that will be held or used for a period longer than one year

fixed cost a cost incurred no matter how many units of a product are produced or sold

flexible benefit plan compensation plan whereby employees receive a predetermined amount of benefit dollars to spend on a package of benefits they have selected to meet individual needs

flexible manufacturing system (FMS) a production system that combines electronic machines and computer-integrated manufacturing that can easily adapt to changes in the type of product being produced

flextime a system in which employees set their own work hours within employer-determined limits

foreign corporation a corporation in any state in which it does business except the one in which it is incorporated

form utility utility created by people converting raw materials, finances, and information into finished products or services

forum an interactive version of a community bulletin board that focuses on threaded discussions

franchise a license to operate an individually owned business as though it were part of a chain of outlets or stores

franchisee a person or organization purchasing a franchise

franchising the actual granting of a franchise

franchisor an individual or organization granting a franchise

free enterprise the system of business in which individuals are free to decide what to produce, how to produce it, and at what price to sell it

frequent-user incentive a program developed to reward customers who engage in repeat (frequent) purchases

full-service wholesaler an intermediary that performs the entire range of wholesaler functions

G

General Agreement on Tariffs and Trade (GATT) an international organization of nations dedicated to reducing or eliminating tariffs and other barriers to world trade

general-merchandise wholesaler an intermediary that deals in a wide variety of products

general partner a person who assumes full or shared responsibility for operating a business

generally accepted accounting principles (GAAPs) an accepted set of guidelines and practices for U.S. companies reporting financial information and for the accounting profession

generic product (or **generic brand)** a product with no brand at all

goal an end result that an organization is expected to achieve over a one- to ten-year period

goal-setting theory a theory of motivation suggesting that employees are motivated to achieve goals that they and their managers establish together

grapevine the informal communications network within an organization

green IT a term used to describe all of a firm's activities to support a healthy environment and sustain the planet

green marketing the process of creating, making, delivering, and promoting products that are environmentally safe

grievance procedure a formally established course of action for resolving employee complaints against management

gross domestic product (GDP) the total dollar value of all goods and services produced by all people within the boundaries of a country during a specified time period—usually a one-year period

gross profit a firm's net sales *less* the cost of goods sold

gross sales the total dollar amount of all goods and services sold during the accounting period

H

hard-core unemployed workers with little education or vocational training and a long history of unemployment

hashtag a word or a short phrase preceded by the pound sign (#), to identify different topics

health maintenance organization (HMO) an insurance plan that directly employs or contracts with selected physicians and hospitals to provide healthcare services in exchange for a fixed, prepaid monthly premium

healthcare insurance insurance that covers the cost of medical attention, including hospital care, physicians' and surgeons' fees, prescription medicines, and related services

high-risk investment an investment made in the uncertain hope of earning a relatively large profit in a short time

hostile takeover a situation in which the management and board of directors of a firm targeted for acquisition disapprove of the merger

hourly wage a specific amount of money paid for each hour of work

human relations the study of people and groups in the workplace and what motivates them to achieve organizational goals

human resources management (HRM) all the activities involved in acquiring, maintaining, and developing an organization's human resources

human resources manager a person charged with managing an organization's human resources programs

human resources planning the development of strategies to meet a firm's future human resources needs

hygiene factors job factors that reduce dissatisfaction when present to an acceptable degree but that do not necessarily result in high levels of motivation

I

implied warranty a guarantee imposed or required by law

import quota a limit on the amount of a particular good that may be imported into a country during a given period of time

importing purchasing raw materials or products in other nations and bringing them into one's own country

inbound marketing a marketing term that describes new ways of gaining attention and ultimately customers by creating content on a website that pulls customers in

incentive payment a payment in addition to wages, salary, or commissions

income statement a summary of a firm's revenues and expenses during a specified accounting period

independent retailer a firm that operates only one retail outlet

individual branding the strategy in which a firm uses a different brand for each of its products

industrial union an organization of both skilled and unskilled workers in a single industry

inflation a general rise in the level of prices

influencer a person known on social media who has an influence over a large number of followers

informal group a group created by the members themselves to accomplish goals that may or may not be relevant to an organization

informal organization the pattern of behavior and interaction that stems from personal rather than official relationships

information data presented in a form that is useful for a specific purpose

initial public offering (IPO) occurs when a corporation sells common stock to the general public for the first time

injunction a court order requiring a person or group either to perform some act or to refrain from performing some act

inland marine insurance insurance that protects against loss or damage to goods shipped by rail, truck, airplane, or inland barge

inspection the examination of the quality of work-in-process

institutional advertising advertising designed to enhance a firm's image or reputation

insurable risk a risk that insurance companies will assume

insurance the protection against loss that the purchase of an insurance policy affords

insurance policy the contract between an insurer and the person or firm whose risk is assumed

insurer (or **insurance company)** a firm that agrees, for a fee, to assume financial responsibility for losses that may result from a specific risk

intangible assets assets that do not exist physically but that have a value based on the rights or privileges they confer on a firm

integrated marketing communications coordination of promotion efforts to ensure maximal informational and persuasive impact on customers

intensive distribution the use of all available outlets for a product

interlocking directorate an arrangement in which members of the board of directors of one firm are also directors of a competing firm

intermittent process a manufacturing process in which a firm's manufacturing machines and equipment are changed to produce different products

international business all business activities that involve exchanges across national boundaries

International Monetary Fund (IMF) a 190-member international bank that makes short-term loans to developing countries experiencing balance-of-payment deficits

International Organization for Standardization (ISO) a network of national standards institutes and similar organizations from 165 different countries that is charged with developing standards for quality products and services and environmental standards for global manufacturers and producers

interpersonal skills the ability to deal effectively with other people

inventory management (control) the process of managing inventories in such a way as to minimize inventory costs, including both holding costs and potential stock-out costs

inventory turnover a financial ratio calculated by dividing the cost of goods sold in one year by the average value of the inventory

investment banking firm an organization that assists corporations in raising funds, usually by helping to sell new issues of stocks, bonds, or other financial securities

invisible hand a term created by Adam Smith to describe how an individual's personal gain benefits others and a nation's economy

involuntary bankruptcy a bankruptcy procedure initiated by creditors

J

job analysis a systematic procedure for studying jobs to determine their various elements and requirements

job description a list of the elements that make up a particular job

job design structuring the tasks and activities required to accomplish a firm's objectives into specific jobs so as to foster productivity and employee satisfaction

job enlargement expanding a worker's assignments to include additional but similar tasks

job enrichment a motivation technique that provides employees with more variety and responsibility in their jobs

job evaluation the process of determining the relative worth of the various jobs within a firm

job redesign a type of job enrichment in which work is restructured to cultivate the worker–job match

job rotation the systematic shifting of employees from one job to another

job security protection against the loss of employment

job sharing an arrangement whereby two people share one full-time position

job specialization the separation of all organizational activities into distinct tasks and the assignment of different tasks to different people

job specification a list of the qualifications required to perform a particular job

joint venture an agreement between two or more groups to form a business entity in order to achieve a specific goal or to operate for a specific period of time

jurisdiction the right of a particular union to organize particular groups of workers

just-in-time inventory (JIT) system a system designed to ensure that materials or supplies arrive at a facility just when they are needed so that storage and holding costs are minimized

K

key performance indicators (KPIs) measurements that define and measure the progress of an organization toward achieving its objectives

knowledge management (KM) a firm's procedures for generating, using, and sharing important data and information

L

labeling the presentation of information on a product or its package

labor-intensive technology a process in which people must do most of the work

labor union an organization of workers acting together to negotiate their wages and working conditions with employers

laissez-faire leadership a hands-off leadership style that provides direction, tools, and resources to employees while delegating responsibility and decision-making authority to them

law a rule developed by a society to govern the conduct of and relationships among its members

leadership the ability to influence others

leading the process of influencing people to work toward a common goal

lean manufacturing a concept built on the idea of eliminating waste from all of the activities required to produce a product or service

lease an agreement by which the right to use real estate, equipment, or other assets is temporarily transferred from its owner to the user

letter of credit a legal document issued by a bank or other financial institution guaranteeing to pay a seller a stated amount for a specified period of time if certain conditions or requirements are met

liabilities a firm's debts and obligations

licensing a contractual agreement in which one firm permits another to produce and market its product and to use its brand name in return for a royalty or other compensation

life insurance insurance that pays a stated amount of money on the death of the insured individual

lifestyle shopping center an open-air-environment shopping center with upscale chain specialty stores

limit order a request that a security be bought or sold at a price that is equal to or better than some specified price

limited liability a feature of corporate ownership that limits each owner's financial liability to the amount of money that they have paid for the corporation's stock

limited liability company (LLC) a form of business ownership that combines the benefits of a corporation and a partnership while avoiding some of the restrictions and disadvantages of those forms of ownership

limited-line wholesaler an intermediary that stocks only a few product lines but carries numerous product items within each line

limited partner a person who invests money in a business but has no management responsibility or liability for losses beyond the amount they invested in the partnership

line-and-staff structure an organizational structure that utilizes the chain of command from a line structure in combination with the assistance of staff managers

line extension development of a new product that is closely related to one or more products in the existing product line but designed specifically to meet somewhat different customer needs

line managers managers who make decisions and give orders to subordinates to achieve the organization's goals

line of credit a loan that is approved before the money is actually needed

line structure an organizational structure in which the chain of command goes directly from person to person throughout the organization

liquidity the ease with which an asset can be converted into cash

lockout a firm's refusal to allow employees to enter the workplace

logistics all those activities concerned with the efficient flow and storage of products from the producer to the ultimate user

long-term financing money that will be used for longer than one year

long-term liabilities debts that need not be repaid for at least one year

lump-sum salary increase an entire pay raise taken in one lump sum

M

macroeconomics the study of the national economy and the global economy

maintenance shop a workplace in which employees who join the union must remain union members as long as they are employed by the firm

major equipment large tools and machines used for production purposes

Malcolm Baldrige National Quality Award an award given by the president of the United States to organizations judged to be outstanding in specific managerial tasks that lead to improved quality for both products and services

malware a general term that describes software designed to infiltrate a computer system without the user's consent

management the process of coordinating people and other resources to achieve the goals of an organization

management by objectives (MBO) a motivation technique in which managers and employees collaborate in setting goals

management development the process of preparing managers and other professionals to assume increased responsibility in both present and future positions

management information system (MIS) a system that provides managers and employees with the information they need to perform their jobs as effectively as possible

managerial accounting provides managers and employees with the information needed to make decisions about a firm's financing, investing, marketing, and operating activities

manufacturer (or **producer) brand** a brand that is owned by a manufacturer

margin requirement the portion of the price of a stock that cannot be borrowed

market a group of individuals or organizations, or both, that need products in a given category and that have the ability, willingness, and authority to purchase them

market allocation an agreement to divide a market among potential competitors

market economy an economic system in which businesses and individuals decide what to produce and buy, and the market determines prices and quantities sold

market order a request that a security be purchased or sold at the current market price

market price the price at which the quantity demanded is exactly equal to the quantity supplied

market segment a group of individuals or organizations within a market that shares one or more common characteristics

market segmentation the process of dividing a market into segments and directing a marketing mix at a particular segment or segments rather than at the total market

marketing the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large

marketing analytics the collection, organization, and interpretation of data about marketing performance

marketing concept a business philosophy that a firm should provide goods and services that satisfy customers' needs through a coordinated set of activities that allow the firm to achieve its objectives

marketing manager a manager who is responsible for facilitating the exchange of products between an organization and its customers or clients

marketing mix a combination of product, price, distribution, and promotion developed to satisfy a particular target market

marketing plan a written document that specifies an organization's resources, objectives, strategy, and implementation and control efforts to be used in marketing a specific product or product group

marketing research the process of systematically gathering, recording, and analyzing data concerning a particular marketing problem

marketing strategy a plan that will enable an organization to make the best use of its resources and advantages to meet its objectives

markup the amount a seller adds to the cost of a product to determine its basic selling price

Maslow's hierarchy of needs a sequence of human needs in the order of their importance

mass production a manufacturing process that lowers the cost required to produce a large number of identical or similar products over a long period of time

materials handling the actual physical handling of goods, in warehouses as well as during transportation

material requirements planning (MRP) a computerized system that integrates production planning and inventory control

matrix structure an organizational structure that combines vertical and horizontal lines of authority, usually by superimposing product departmentalization on a functionally departmentalized organization

maturity date the date on which a corporation is to repay borrowed money

media sharing sites websites which allow users to upload photos, videos, and podcasts

mediation the use of a neutral third party to assist management and the union during their negotiations

mentors older, higher-ranked employees who instruct, advise, and offer support to younger employees in the ways of the organization and industry

merchant wholesaler an intermediary that purchases goods in large quantities and sells them to other wholesalers or retailers and to institutional, farm, government, professional, or industrial users

merger the combining of two corporations or other business entities to form one business

microeconomics the study of the decisions made by individuals and businesses

middle manager a manager who implements the strategy and major policies developed by top management

middleman (or **marketing intermediary)** a marketing organization that links a producer and user within a marketing channel

mission a statement of the basic purpose that makes an organization different from others

missionary salesperson a salesperson—generally employed by a manufacturer—who visits retailers to persuade them to buy the manufacturer's products

mixed economy an economy that exhibits elements of both capitalism and socialism

mobile marketing communicating with and selling to customers through mobile devices

mobile payment allows customers to use an electronic device or app to pay for a product or service

monetary policies Federal Reserve's actions to promote maximum employment, stabilize prices, and increase or decrease interest rates

monopolistic competition a market situation in which there are many buyers along with a relatively large number of sellers who differentiate their products from the products of competitors

monopoly a market (or industry) with only one seller, and customers can only buy the product or service from that seller

morale an employee's feelings about the job, about superiors, and about the firm itself

mortgage bond a corporate bond secured by various assets of the issuing firm

motivating the process of providing reasons for people to work in the best interests of an organization

motivation the individual internal process that energizes, directs, and sustains behavior; the personal "force" that causes you or me to behave in a particular way

motivation factors job factors that increase motivation, although their absence does not necessarily result in dissatisfaction

motivation-hygiene theory the idea that satisfaction and dissatisfaction are separate and distinct dimensions

multichannel (or **omnichannel) distribution** the use of a variety of marketing channels to ensure maximum distribution

multichannel retailing employing multiple types of retailing

multilateral development bank (MDB) an internationally supported bank that provides loans to developing countries to help them grow

multinational corporation a firm that operates on a worldwide scale without ties to any specific nation or region

multiple-unit pricing the strategy of setting a single price for two or more units

municipal bond sometimes called a *muni,* a debt security issued by a state or local government

mutual fund an investment in which the money of many investors—its shareholders—is pooled for investing in a variety of different securities

mutual insurance company an insurance company that is owned collectively by its policyholders and is thus a cooperative

N

national debt the total of all federal deficits

National Labor Relations Board (NLRB) the federal agency that enforces the provisions of the Wagner Act

negligence a failure to exercise reasonable care, resulting in injury to another

negotiable instrument a written document that (1) is a promise to pay a stated sum of money and (2) can be transferred from one person or firm to another

negotiated pricing establishing a final price through bargaining

neighborhood shopping center a planned shopping center consisting of several small convenience and specialty stores

net asset value (NAV) current market value of a mutual fund's portfolio minus the mutual fund's liabilities divided by the number of outstanding shares

net income occurs when revenues exceed expenses

net loss occurs when expenses exceed revenues

net profit margin (or **return on sales)** a financial ratio calculated by dividing net income after taxes by net sales

net sales the actual dollar amounts received by a firm for the goods and services it has sold after adjustment for returns, allowances, and discounts

net worth the difference between the value of your total assets and your total liabilities

news release a typed page of about 300 words provided by an organization to the media as a form of publicity

no-fault auto insurance enacted by state law and requires that those suffering injury or loss be reimbursed by their own insurance companies, without regard to who was at fault in the accident

non-price competition competition based on factors other than price

nonstore retailing selling that does not take place in conventional store facilities

nontariff barrier a nontax measure imposed by a government to favor domestic over foreign suppliers

not-for-profit corporation (sometimes referred to as *nonprofit*) a corporation organized to provide a social, educational, religious, or other service rather than to earn a profit

O

objective a specific statement detailing what an organization intends to accomplish over a shorter period of time

ocean marine insurance insurance that protects the policyholder against loss or damage to a ship or its cargo on the high seas

odd-number pricing the strategy of setting prices using odd numbers that are slightly below whole-dollar amounts

off-price retailer a store that buys manufacturers' seconds, overruns, returns, and off-season merchandise for resale to consumers at deep discounts

oligopoly a market (or industry) in which there are few sellers

onboarding the process of integrating new employees into an organization

online retailing retailing that makes products available to buyers through computer or mobile connections

open corporation (sometimes referred to as a public corporation) a corporation whose stock can be bought and sold by any individual

open-end fund a type of mutual fund in which the sponsoring investment company issues and sells new shares to any investor who requests them and buys back shares from investors who wish to sell them

operating expenses all business costs other than the cost of goods sold

operational plan a type of plan designed to implement tactical plans

operations management all the activities required to produce goods and services

operations manager a manager who manages the systems that convert resources into goods and services

order getter a salesperson who is responsible for selling a firm's products to new customers and increasing sales to current customers

order processing activities involved in receiving and filling customers' purchase orders

order taker a salesperson who handles repeat sales in ways that maintain positive relationships with customers

organization a group of two or more people working together to achieve a common set of goals

organization chart a diagram that represents the positions and relationships within an organization

organizational culture the inner rituals, traditions, processes, and values of a firm

organizational height the number of layers, or levels, of management in a firm

organizing the grouping of resources and activities to accomplish some end result in an efficient and effective manner

orientation the basic introduction of new employees to an organization

outsourcing an arrangement in which one firm contracts manufacturing or other activities to a firm in another country that specializes in those activities and can offer them at a lower cost than domestic firms

over-the-counter (OTC) market a network of dealers who buy and sell the stocks of corporations that are not listed on a securities exchange

overtime time worked in excess of 40 hours in one week (under some union contracts, time worked in excess of eight hours in a single day)

owners' equity the difference between a firm's assets and its liabilities

P

packaging all the activities involved in developing and providing a container with graphics for a product

participative leadership leadership style in which all members of a team are involved in identifying essential goals and developing strategies to reach those goals

partnership a voluntary association of two or more persons to act as co-owners of a business for profit

part-time work permanent employment in which individuals work less than a standard work week

patent the exclusive right to make, use, or sell a newly invented product or process

penetration pricing the strategy of setting a low price for a new product to build market share quickly

perfect (or **pure) competition** the market situation in which there are many buyers and sellers of a product, and no single buyer or seller is powerful enough to affect the price of that product

performance the fulfillment of all obligations by all parties to the contract

performance appraisal the evaluation of employees' performance to allow managers to make objective human resources decisions

periodic discounting temporary reduction of prices on a patterned or systematic basis

personal balance sheet a summary of your assets and liabilities, as well as your calculated net worth, on a specific date

personal budget a specific plan for spending your income

personal income the income an individual receives from all sources

personal income statement a summary of your income and expenses for a specific period of time—usually a month—which shows if you have a surplus or a deficit at the end of the time period

personal investment the use of your personal funds to earn a financial return

personal property all property other than real property

personal selling personal communication aimed at informing customers and persuading them to buy a firm's products

picketing marching back and forth in front of a place of employment with signs informing the public that a strike is in progress

place utility utility created by making a product available at a location where customers wish to purchase it

plagiarism knowingly taking someone else's words, ideas, or other original material without acknowledging the source

plan an outline of the actions by which an organization intends to accomplish its goals and objectives

planning establishing organizational goals and deciding how to accomplish them

planning horizon the time period during which an operational plan will be in effect

plant layout the arrangement of machinery, equipment, and personnel within a production facility

podcasts digital audio or video files that people listen to or watch online on tablets, computers, smartphones, or other mobile devices

point-of-purchase display promotional material placed within a retail store

pollution the contamination of water, air, or land through the actions of people in an industrialized society

possession utility utility created by transferring title (or ownership) of a product to a buyer

power of attorney a legal document that serves as evidence that an agent has been appointed to act on behalf of a principal

preferred provider organization (PPO) an insurance plan that offers the services of doctors and hospitals at discount rates or gives breaks in copayments and deductibles

preferred stock stock owned by individuals or firms who usually do not have voting rights but whose claims on dividends are paid before those of common-stock owners

premium a gift that a producer offers a customer in return for buying its product; the fee charged by an insurance company

premium pricing pricing the highest-quality or most-versatile products higher than other models in the product line

press conference a meeting at which invited media personnel hear important news announcements and receive supplementary textual materials and photographs

price the amount of money a seller is willing to accept in exchange for a product at a given time and under given circumstances

price competition an emphasis on setting a price equal to or lower than competitors' prices to gain sales or market share

price discrimination the practice in which producers and wholesalers charge larger firms a lower price for goods than they charge smaller firms

price fixing an agreement between two businesses about the prices to be charged for goods

price leaders products priced below the usual markup, near cost, or below cost

price lining the strategy of selling goods only at certain predetermined prices that reflect definite price breaks

price skimming the strategy of charging the highest possible price for a product during the introduction stage of its life cycle

primary-demand advertising advertising whose purpose is to increase the demand for *all* brands of a product within a specific industry

primary market a market in which an investor purchases financial securities (via an investment bank) directly from the issuer of those securities

prime interest rate the lowest rate charged by a bank for a short-term loan

principle of indemnity in the event of a loss, an insured firm or individual cannot collect from the insurer an amount greater than the actual dollar amount of the loss

private law the body of law that governs the relationships between two or more individuals or businesses

private placement occurs when stock and other corporate securities are sold directly to wealthy investors, banks and financial firms, insurance companies, pension funds, large institutional investors, or mutual funds

problem the discrepancy between an actual condition and a desired condition

problem-solving team a team of knowledgeable employees brought together to tackle a specific problem

process material a material that is used directly in the production of another product but is not readily identifiable in the finished product

producer price index (PPI) a monthly index that measures prices that producers receive for their finished goods

product everything one receives in an exchange, including all tangible and intangible attributes and expected benefits; it may be a good, a service, or an idea

product deletion the elimination of one or more products from a product line

product design the process of creating a set of specifications from which a product can be produced

product differentiation the process of developing and promoting differences between a company's products and all competitive products

product liability insurance insurance that protects the policyholder from financial losses due to injuries suffered by others as a result of using the policyholder's products

product life cycle a series of stages in which a product's sales revenue and profit increase, reach a peak, and then decline

product line a group of similar products that differ only in relatively minor characteristics

product mix all the products a firm offers for sale

product modification the process of changing one or more of a product's characteristics

productivity the average level of output per worker per hour

profit what remains after all business expenses have been deducted from sales revenue

profit sharing the distribution of a percentage of a firm's profit among its employees

progressive tax a tax that requires the payment of an increasing proportion of income as the individual's income increases

promissory note a written pledge by a borrower to pay a certain sum of money to a creditor at a specified future date

promotion communication about an organization and its products that is intended to inform, persuade, or remind target-market members

promotion mix the particular combination of promotion methods a firm uses to reach a target market

property anything that can be owned

proportional tax a tax whose percentage rate remains constant as the tax base increases

prospectus a detailed, written description of a new security, the issuing corporation, and the corporation's top management

proxy a legal form listing issues to be decided at a stockholders' meeting and enabling stockholders to transfer their voting rights to some other individual or individuals

public law the body of law that deals with the relationships between individuals or businesses and society

public liability insurance insurance that protects the policyholder from financial losses due to injuries suffered by others as a result of negligence on the part of a business owner or employee

public relations communication activities used to create and maintain favorable relationships between an organization and various public groups, both internal and external

publicity communication in news-story form about an organization, its products, or both

purchasing all the activities involved in obtaining required materials, supplies, components, and parts from other firms

pure risk a possibility of loss or harm that involves only the threat of loss, with no potential for gain

Q

qualitative social media measurement the process of accessing the opinions and beliefs about a brand

quality circle a team of employees who meet on company time to solve problems of product quality

quality control the process of ensuring that goods and services are produced in accordance with design specifications

quantitative social media measurement using numerical measurements, such as counting the number of website visitors, number of fans and followers, number of leads generated, and the number of new customers

R

random discounting temporary reduction of prices on an unsystematic basis

rate of return the total dollar amount of return you receive on an investment over a specific period of time divided by the amount invested

ratification approval of a labor contract by a vote of the union membership

raw material a basic material that actually becomes part of a physical product; usually comes from mines, forests, oceans, or recycled solid wastes

real property land and anything permanently attached to it

rebate a return of part of the purchase price of a product

recession two or more consecutive three-month periods of decline in a country's GDP

recruiting the process of attracting qualified job applicants

recycling converting used materials into new products or components for new products in order to prevent their unnecessary disposal

reference pricing pricing a product at a moderate level and positioning it next to a more expensive model or brand

regional shopping center a planned shopping center containing large department stores, numerous specialty stores, restaurants, movie theaters, and sometimes even hotels

registered bond a bond registered in the owner's name by the issuing company

regressive tax a tax that takes a greater percentage of a lower income than of a higher income

reinforcement theory a theory of motivation based on the premise that rewarded behavior is likely to be repeated, whereas punished behavior is less likely to recur

relationship marketing establishing long-term, mutually satisfying buyer–seller relationships

replacement chart a list of key personnel and their possible replacements within a firm

research and development (R&D) a set of activities intended to identify new ideas that have the potential to result in new goods and services

reshoring a situation in which U.S. manufacturers bring manufacturing jobs back to the United States

responsibility the duty to do a job or perform a task

retailer an intermediary that buys from producers or other middlemen and sells to consumers

retained earnings the portion of a business's profits not distributed to stockholders

revenue stream a source of revenue flowing into a firm

revenues the dollar amounts earned by a firm from selling goods, providing services, or performing business activities

revolving credit agreement a guaranteed line of credit

risk the possibility that a loss or injury will occur

risk management the process of evaluating the possible threats faced by a firm or an individual and then minimizing the costs involved should those threats actually come to pass

risk–return ratio a ratio based on the principle that a high-risk decision should generate higher financial returns for a business and more conservative decisions often generate lower returns

robotics the creation and application of programmable machines to perform a variety of tasks by manipulating materials and tools

S

S corporation a corporation that is taxed as though it were a partnership

salary a specific amount of money paid for an employee's work during a set calendar period, regardless of the actual number of hours worked

sales agreement a type of contract by which ownership is transferred from a seller to a buyer

sales forecast an estimate of the amount of a product that an organization expects to sell during a certain period of time based on a specified level of marketing effort

sales promotion the use of activities or materials as direct inducements to customers or salespersons

sales support personnel employees who aid in selling but are more involved in locating prospects, educating customers, building goodwill for the firm, and providing follow-up service

sample a free product given to customers to encourage trial and purchase

Sarbanes-Oxley Act of 2002 provides sweeping legal protection for employees who report corporate misconduct

scheduling the process of ensuring that materials and other resources are at the right place at the right time

scientific management the application of scientific principles to management of work and workers

secondary market a market for existing financial securities that are traded between investors

secondary-market pricing setting one price for the primary target market and a different price for another market

securities exchange a marketplace where member brokers meet to buy and sell securities

selection the process of gathering information about applicants for a position and then using that information to choose the most appropriate applicant

selective-demand (or **brand) advertising** advertising that is used to sell a particular brand of product

selective distribution the use of only a portion of the available outlets for a product in each geographic area

self-insurance the process of establishing a monetary fund that can be used to cover the cost of a loss

self-managed teams groups of employees with the authority and skills to manage themselves

selling short the process of selling stock that an investor does not actually own but has borrowed from a brokerage firm and will repay at a later date

seniority the length of time an employee has worked for an organization

sentiment analysis a measurement that uses technology to detect the mood, attitudes, or emotions of people who experience a social media activity

serial bonds bonds of a single issue that mature on different dates

Service Corps of Retired Executives (SCORE) a group of businesspeople who volunteer their services to small businesses through the SBA

service economy an economy in which more effort is devoted to the production of services than to the production of goods

shop steward an employee elected by union members to serve as their representative

shopping product an item for which buyers are willing to expend considerable effort on planning and making the purchase

short-term financing money that will be used for one year or less

sinking fund a sum of money to which deposits are made each year for the purpose of redeeming a bond issue

Six Sigma a disciplined approach that relies on statistical data and improved methods to eliminate defects for a firm's products and services

skills inventory a computerized data bank containing information on the skills and experience of all present employees

slowdown a technique whereby workers report to their jobs but work at a slower pace than normal

small business an independent business with fewer than 500 employees, depending on its industry

Small Business Administration (SBA) a government agency that assists, counsels, and protects the interests of small businesses in the United States

small-business development centers (SBDCs) university-based groups that provide individual counseling and practical training to owners of small businesses

small-business institutes (SBIs) groups of senior and graduate students in business administration who provide management counseling to small businesses

small-business investment companies (SBICs) privately owned firms that provide venture capital to small enterprises that meet their investment standards

social audit a comprehensive report of what an organization has done and is doing with regard to social issues that affect it

social content sites websites which allow companies to create and share information about their products and services

social media the online interaction that allows people and businesses to communicate and share ideas, personal information, and information about products or services

social media communities groups of people who share common interests and who want to use technology and the internet to connect with people with similar interests

social media community manager a high-level executive who is responsible for all of a company's social media activities

social media marketing the utilization of software, computer technology, and the internet to provide information about a firm's products and services, increase sales revenues, and improve customer service

social responsibility the recognition that business activities have an impact on society and the consideration of that impact in business decision making

socioeconomic model of social responsibility the concept that business should emphasize not only profits but also the impact of its decisions on society

sole proprietorship a business that is owned (and usually operated) by one person

span of management (or **span of control)** the number of workers who report directly to one manager

special-event pricing advertised sales or price cutting linked to a holiday, season, or event

specialization the separation of a manufacturing process into distinct tasks and the assignment of different tasks to different individuals

specialty product an item that possesses one or more unique characteristics for which a significant group of buyers is willing to expend considerable purchasing effort

specialty wholesaler an intermediary that carries a select group of products within a single line

specific performance the legal requirement that the parties to a contract fulfill their obligations according to the contract

speculative production the time lag between the actual production of goods and when the goods are sold

speculative risk the possibility of loss or harm that accompanies the potential of earning a profit

staff managers managers who to provide support, advice, and expertise to line managers

stakeholders all the different people or groups of people who are affected by an organization's policies, decisions, and activities

standard of living a loose, subjective measure of how well off an individual or a society is, mainly in terms of want satisfaction through goods and services

Standard & Poor's 500 Stock Index an index that contains 500 different stocks that reflect increases or decreases in value for the U.S. stock market as a whole

standing committee a relatively permanent committee charged with performing some recurring task

statement of cash flows a statement that illustrates how the company's operating, investing, and financing activities affect cash during an accounting period

statistic a measure that summarizes a particular characteristic of an entire group of numbers

statute a law passed by the United States Congress, a state legislature, or a local government

statutory law all the laws that have been enacted by legislative bodies

stock the shares of ownership of a corporation

stock dividend a dividend in the form of additional stock

stock insurance company an insurance company owned by stockholders and operated to earn a profit

stock split the division of each outstanding share of a corporation's stock into a greater number of shares

stockholder a person who owns a corporation's stock

store (or **private) brand** a brand that is owned by an individual wholesaler or retailer

strategic alliance a partnership formed to create competitive advantage on a worldwide basis

strategic plan an organization's broadest plan, developed as a guide for major policy setting and decision making

strategic planning process the establishment of an organization's major goals and objectives and the allocation of resources to achieve them

strike a temporary work stoppage by employees, calculated to add force to their demands

strikebreaker a nonunion employee who performs the job of a striking union member

supermarket a large self-service store that sells primarily food and household products

superstore a large retail store that carries not only food and nonfood products ordinarily found in supermarkets but also additional product lines

supply the quantity of a product that producers are willing to sell at each of various prices

supply-chain management the coordination of all marketing channel activities associated with the flow and transformation of supplies, products, and information throughout the supply chain to the ultimate consumer

sustainability the ability to create and maintain conditions under which present and future generations can exist in productive harmony, and permit fulfilling the social, economic, and other requirements of future and present generations

SWOT analysis the identification and evaluation of a firm's strengths, weaknesses, opportunities, and threats

syndicate a temporary association of individuals or firms organized to perform a specific task that requires a large amount of money

synthetic process a process in operations management in which raw materials or components are combined to create a finished product

T

tactical plan a smaller-scale plan developed to implement a strategy

target market a group of individuals or organizations, or both, for which a firm develops and maintains a marketing mix suitable for the specific needs and preferences of that group

tariff a tax levied on a particular foreign product entering a country

task force a committee established to investigate a major problem or pending decision

team two or more workers collaborating to achieve a shared mission, goal, or work product

technical salesperson a salesperson who assists a company's current customers in technical matters

technical skills specific skills needed to accomplish a specialized activity

telecommuting working remotely all the time or for a portion of the work week

telemarketing the performance of marketing-related activities by telephone

television home shopping a form of selling in which products are presented to television viewers, who can buy them by calling a toll-free number and paying with a credit card

term life insurance life insurance that provides protection to beneficiaries for a stated period of time

term-loan agreement a promissory note that requires a borrower to repay a loan in monthly, quarterly, semiannual, or annual installments

terminations involuntary separations

Theory X a concept of employee motivation generally consistent with Taylor's scientific management; assumes that employees dislike work and will function only in a highly controlled work environment

Theory Y a concept of employee motivation generally consistent with the ideas of the human relations movement; assumes responsibility and work toward organizational goals, and by doing so employees also achieve personal rewards

Theory Z a concept of management which emphasizes participative decision making, with a holistic concern for employees

time utility utility created by making a product available when customers wish to purchase it

top manager an upper-level executive who guides and controls the overall fortunes of an organization

tort a violation of a private law

total cost the sum of the fixed costs and the variable costs attributed to a product

total quality management (TQM) the coordination of efforts directed at improving customer satisfaction, increasing employee participation, strengthening supplier partnerships, and facilitating an organizational atmosphere of continuous quality improvement

total revenue the total amount received from the sales of a product

trade credit a type of short-term financing extended by a seller who does not require immediate payment after delivery of merchandise

trade deficit a negative balance of trade

trade name the complete and legal name of an organization

trade sales promotion method a sales promotion method designed to encourage wholesalers and retailers to stock and actively promote a manufacturer's product

trade salesperson a salesperson—generally employed by a food producer or processor—who assists customers in promoting products, especially in retail stores

trade show an industry-wide exhibit at which many sellers display their products

trademark a brand name or brand mark that is registered with the U.S. Patent and Trademark Office and thus is legally protected from use by anyone except its owner

trading company provides a link between buyers and sellers in different countries

traditional specialty store a store that carries a narrow product mix with deep product lines

transactional leadership leadership style that emphasizes structure, performance and productivity, and reward systems

transfer pricing prices charged in sales between an organization's units

transformational leadership leadership style that focuses on transforming organizations and industries

transportation the shipment of products to customers

trust a business combination created when one firm obtains control of an entire industry and can set prices and manipulate trade to suit its own interest

trustee an individual or an independent firm that acts as a bond owner's representative

turnover when employees leave their jobs

tying agreement a contract that forces an intermediary to purchase unwanted products along with the products it actually wants to buy

U

undifferentiated approach directing a single marketing mix at the entire market for a particular product

unemployment rate the percentage of a nation's labor force unemployed at any time

Uniform Commercial Code (UCC) a set of laws designed to eliminate differences among state regulations affecting business and to simplify interstate commerce

uninsurable risk a risk that insurance companies will not assume

union-management relations (or **labor relations)** the dealings between labor unions and business management both in the bargaining process and beyond it

union security protection of the union's position as the employees' bargaining agent

union shop a workplace in which new employees must join the union after a specified probationary period

universal life insurance life insurance that combines insurance protection with an investment plan that offers a potentially greater return than that guaranteed by a whole life insurance policy

unlimited liability a legal concept that holds a business owner personally responsible for all the debts of the business

unsecured financing financing that is not backed by collateral

unsought product an item that people do not plan on purchasing, such as one that addresses a sudden problem or that customers are unaware of until they see it in a store or online

usury the practice of charging interest in excess of the maximum legal rate

utility the ability of a good or service to satisfy a human need

V

value a customer's estimation of the worth of a product based on a comparison of its costs and benefits, including quality, relative to other products

variable cost a cost that depends on the number of units produced

vending the use of machines to dispense products

venture capital money that is invested in small (and sometimes struggling) firms that have the potential to become successful

virtual structure an organizational structure in which administration is the primary function, and most other functions are contracted out to other firms

virtual team a team consisting of members who are geographically dispersed but communicate electronically

voluntary agreement a contract requirement consisting of an offer by one party to enter into a contract with a second party and acceptance by the second party of all the terms and conditions of the offer

voluntary bankruptcy a bankruptcy procedure initiated by an individual or business that can no longer meet its financial obligations

W

wage survey a collection of data on prevailing wage rates within an industry or a geographic area

warehouse club a large-scale members-only establishment that combines features of cash-and-carry wholesaling with discount retailing

warehouse showroom a retail facility in a large, low-cost building with a large on-premises inventory and minimal service

warehousing the set of activities involved in receiving and storing goods and preparing them for reshipment

whistle-blowing informing the press or government officials about unethical practices within one's organization

whole life insurance life insurance that provides both protection and savings

wholesaler an intermediary that sells products to other firms

wiki a collaborative online working space that enables members to contribute content that can be shared with other people

wildcat strike a strike not approved by the strikers' union

workers' compensation insurance insurance that covers medical expenses and provides salary continuation for employees who are injured while on the job

workplace diversity differences among people in a workforce owing to factors such as age, race, ethnicity, gender, sexual orientation, and ability

World Bank a cooperative banking institution with 189 member countries

World Trade Organization (WTO) a 164-member powerful successor to GATT that facilitates world trade among member nations by mediating disputes and fostering efforts to reduce trade barriers

Z

zero-base budgeting a budgeting approach in which every expense in every budget must be justified

Name Index

Symbols

#MeToo movement, 58

Numbers

3BL Media, 48
3M, 219
7-Eleven, 10, 148, 165, 372

A

AB InBev, 384
Accenture, 48
Accion, 339
ACE Hardware, 145, 409
ACME Homebuilders, 208
Acosta, Jessica, 155
Adobe's Commerce, 420
Advanced Architectural Stone, Inc., 216
Advocacy Center, 89
AdWords, 298
African Development Bank (AFDB), 91
Airbnb, 14, 116, 267
Airbus, 440
Albertsons, 371, 372
Alexa, 334
Alibaba, 69, 136, 371
Allen, Paul, 158
Alphabet, 47, 102, 123, 125, 211, 376
Altair, 158
Aluminum Association, 82
Amazon, 10, 25, 30, 53, 65, 102, 125, 136, 166, 174, 180, 203, 211, 342, 344, 365, 371, 383, 420, 421, 423
Amazon Echo, 333, 334
Amazon Music, 75
Amazon Prime, 65
Amazon Prime Video, 402
Amazon Web Services (AWS), 427
American Airlines, 478
American Electric Power, 472
American Express, 5, 106, 231, 276
Americold Logistics, 60
Ameriprise, 40
AmerisourceBergen, 37
Amway, 375
Ancestry.com, 322
Andrada, Marissa, 246
Anheuser-Busch, 339, 345
Anytime Fitness, 148
Apple, 34, 45, 61, 72, 112, 116, 125, 133, 151, 192, 211, 214, 251, 260, 289, 290, 334, 340, 342, 343, 344, 381, 436, 486
Apple Developer Academy, 251
Apple Music, 75
Apple Pay, 478
Apple TV+, 304, 402
Arbonne, 365
Archer Daniels Midland, 334
Arculus, 215
Asana, 293
Ashley HomeStore, 371
Asian Development Bank (ADB), 91
AT&T, 55, 168, 226–227, 231, 484
Aurora, 102
Avon, 365, 375
Awesome Burger, 179

B

BackRub, 158
Baldwin, Jerry, 326
Bank of America, 61
Bank of America Securities, 122
Banque Africaines de Development, 91
Barnes & Noble, 292
Barnett, Jonathan, 148
Barney, Jen, 154
Barra, Mary, 174–175
Baskin-Robbins, 150
Bath and Body Works, 373
BBDO, 385
Beckham, Victoria, 311
Becky, Kermit, 131
Bedrock Manufacturing, 361
Beeck, Holger, 198
Ben & Jerry's, 97, 397
Benioff, Marc, 260
Ben's Original, 349
Bercaw, Caroline, 139, 140
Bercaw, Isabel, 139, 140
Berkshire Hathaway, 12, 177, 194, 475
Bernhard Schulte Shipmanagement, 59
Berry Global, 226
Best Buy, 9, 104, 366, 371, 467
Bethlehem Steel, 276–277
Beyond Meat, 179, 334
Bezos, Jeff, 102, 136, 144, 174, 180, 203
BigCommerce, 420
Bill and Melinda Gates Foundation, 85
Billie, 151
BioNTech, 79, 122, 219
BizMiner, 458
BizX, 152
BlackRock, 21
Blakely, Sara, 158
Blink, David, 300, 496
Bloomberg, 458
Bluesign, 233
BMW, 11, 120
Bob's Red Mill Natural Foods, 295
BODEN, 391
Boden, Natalie, 391
Boeing Company, 70, 235
Bok, Christian, 137
Bombardier, 338
Bonobos, 134, 365
Bonvoy, 319
Boone Center, Inc., 57
Border X Brewing, 152
The Boring Company, 178
Bossa Nova Robotics, 228
Boston Beer Company, 339
Bowker, Gordon, 326
Brazen, 254
Brewer, Rosalind, 172
BrightLocal, 407
Brightloom, 327
Brin, Sergey, 158
Brinker International, 218, 411
Broadcast.com, 158
Bruce Miller Nurseries, 471
Buffalo's Express, 148
Buffett, Warren, 12, 158, 177, 194
Bureau of Labor Statistics, 469
Burger King, 147, 149, 150, 334, 381
Burlington, 373
Burpee, 375
ByteDance, 319

C

Caesars Entertainment, 63
CafePress, Inc., 235
California Consumer Privacy Act (CCPA), 426
California Milk Processor Board, 381
Callaway Golf, 470
Cameron, Kim, 287
Campbell Soup Company, 179, 219, 346
Cantina, 131
Cardinal Health, 37
CardRates.com, 478
Carnegie, Andrew, 194
Casper, 361, 365, 371, 394–395
Caterpillar, 239, 451
Celadon, 445
Cengage, 342
Center for Policing Equity and Equal Justice Initiative, 47
Chanel, 350
Chase Bank, 339
Chevrolet, 11
Chevron, 216
Chevy Bolt EV, 94
Chewy, 330
Chick-fil-A, 38, 340
Chime, 339
Chipotle Mexican Grill, 61, 246
Church's Chicken, 147
Circle K, 372
Cisco, 48, 61, 62, 124, 136, 170, 276
Citi, 48, 90
Citibank, 216
Citigroup, 62, 260
CleanPath, 346
Clinton, Bill, 52
Clorox Company, 222, 233
Club Demonstration Services, 389
Coach, 229
Coca-Cola, 50, 53, 68, 128, 147, 186, 261, 317, 319, 335, 342, 344, 346, 384, 409, 416
Coinbase, 293
Coldwater Creek, 375
Colgate-Palmolive, 50, 80
Colorado Crossover, 148
Colorado Small Business Development Center Network, 155

Columbia Pictures Entertainment, Inc., 80
Combustion Associates, 68
Commonwealth Management, 152
Consumer Product Safety Commission, 51
Cook, Tim, 192
Cornell, Brian, 430
Costco, 151, 292, 371, 373, 389
CourseMatch, 158
Cracker Barrel Old Country Store, 9
Cream of Wheat, 349
Credit Karma, 140
Crest, 107
Ctrip, 294
Cuban, Mark, 158
Cure Starts Now Foundation, 96
Cutco, 375
CVS Health, 371
CyberX, 211
Cypress Springs Plastics, 488, 489

D

Da Bomb Bath Bombs, 139, 140
Dairy Queen, 12
Dallas Mavericks, 158
Danone North America, 117
Das, Paravi, 406
Davey Tree, 295
daVinci Payments, 291
De Beers, 368
DeJoy, Louis, 40
Deliv, 431
Dell, Michael, 133
Dell Computer, 133, 228, 235, 345, 366, 423
Deloitte, 264, 292, 434
Deloitte Digital, 385
Denman, George, 397
Denny's Inc., 148
Dentsu, 385
DHL, 368
Dick's Sporting Goods, 423
Dillard's, 25
Discord, 140
Disney, 40, 248, 344, 407
Disney+, 402
Dollar General, 262, 365, 372
Dollar Shave Club, 177
Dollar Tree, 372, 490
The Domain, 374
Domino's Pizza, 412
DoorDash, 493–494
Dorsey, Jack, 164
Dove, 112, 379–380
Dow Chemical, 80
D.R. Horton, 437
Dr Pepper, 344
Drano, 127
Dreyer's Grand Ice Cream, 349
Driscoll, Conor, 406
Drori, Ze'ev, 183
Drucker, Peter, 362
Drug Enforcement Administration, 37
Dubin, Michael, 177
Dudley, Joe, 4
Dun & Bradstreet, 318, 421, 458, 476
Dunkin,' 79, 148, 149, 150, 334
Dunn, Andy, 134
DuPont, 29
Dyson, 339
Dyson, James, 340

E

East West Partners, 279
Eastern Sea Precision Machine Company, 94
Eastman Kodak, 153
Eberhard, Martin, 182, 183
Ecolab, 48
Edward Jones, 276
Effie Effectiveness Index, 384
Electrolux, 78
Electronic Arts, 40
e.l.f. Cosmetics, 380
Elliott Management Corp., 164
Ellison, Larry, 122, 462–463
Empanadas on the Go, 153
Enron, 42
Environmental Consulting Services, 155
Environmental Protection Agency, 30, 59
ePolicy Institute, 426
Ernst & Young, 434
Ethics & Compliance Initiative, 194
Etsy, 10, 405–406
European Bank for Reconstruction and Development, 91
Eventbrite, 140
Everlane, 174
Evernote, 140
Export-Import Bank of the United States (Ex-Im Bank), 90–91
ExxonMobil, 188, 444

F

Facebook, 5, 35, 97, 125, 136, 158, 211, 255, 260, 287, 293, 318, 403, 404, 408, 416, 417, 424, 484, 486
FaceMash, 158
FaceTime, 34
Fagan, Gray, 406
Fairlife milk, 53
Fang, Andy, 494
FAT Brands, 148
Fatburger, 148
Favela, David, 152
Federal Aviation Administration (FAA), 376
Federal Bureau of Investigation (FBI), 448
Federal Communications Commission (FCC), 375, 386
Federal Reserve System, 477
Federal Trade Commission (FTC), 38, 41, 53, 62, 357, 361, 375, 386, 427
FedEx, 151, 376
Ferguson Marine, 225
Ferrero Group, 337
Filo, David, 139
Financial Accounting Standards Board (FASB), 444, 456
Financial Industry Regulatory Authority (FINRA), 468
Finicity, 477
Fiverr, 385
Focals, 125
Foil Trade Enforcement Working Group, 82
Folger Coffee Company, 41
Food and Drug Administration (FDA), 51, 386
Foot Locker, 373
Ford, Gerald, 52
Ford Motor Company, 7, 15, 25, 27, 115, 133, 189, 191, 214, 235, 238
Forever 21, 365
Fortune, 45, 61, 170, 268, 276
Fossil Group, 361
Freedom, 41
Fresh Line Keepers, 139
The Fresh Market, 187
Frito-Lay, 336, 342, 413
Froneri, 97
Future Workplace, 176
Fyre Festival, 38

G

Gamble, James, 107
Gap, 7, 373, 407
Gates, Bill, 136, 158
Geico, 323
General Electric, 112, 153, 211, 216, 248, 413
General Mills, 11, 48
General Motors, 19, 25, 29, 48, 80, 94, 119, 120, 135, 164, 174–175, 182, 212, 214, 223, 230, 239, 482, 484
GenScript, 484
Gilbreth, Frank, 276
Gilbreth, Lillian, 276
Gillette, 107, 313
GIPHY, 211
Glad Products Company, 216
Glossier, 365
Go Mobile, 131
Goldman Sachs, 122, 339, 469
Google, 35, 47, 52, 61, 85, 102, 116, 125, 158, 177, 178, 211, 260, 289, 297–298, 334, 344, 404, 427, 486
Google Cloud, 341
Google Pay, 478
Gothait, Hanan, 215
GoToMeeting, 201, 256
Graeter, Chip, 96, 160, 397, 496
Graeter, Louis Charles, 96, 160
Graeter, Regina, 160, 241
Graeter, Richard, 241, 300–301
Graeter, Richard II, 96, 160, 397, 496
Graeter, Robert (Bob), 96, 97, 160, 241, 496
Graeter's, 96–97, 160–161, 241–242, 300–301, 397–398, 470, 496–497
Great Clips, 149, 150
Grill, Carson, 139
Grill, Jason, 139
Group Health Cooperative (GHC), 45
Guess, 374
Gusto, 262

H

H&M, 79, 341
H&R Block, 9, 149
Häagen-Dazs, 97, 397
Habitat for Humanity, 5, 121
Hampton Inn, 148
Hanes, 367
Hard Rock Cafe, 222
Harley Davidson, 228
Harpo Productions, 118, 136
Harpoon Brewing, 295
Haydon, Madeline, 136
HBO, 304
HBO Max, 402, 406
H-E-B, 169, 372
Herbalife Nutrition, 40
Hershey Company, 449
Hertz, 11
Herzberg, Frederick, 279, 289, 295
Hess, 48
Hewlett-Packard (HP), 48, 50, 133, 295
Hickory White, 228–229
Highmass, 208
Hilton, 176, 276
Hispanic Chamber of Commerce, 155
H.J. Heinz, 336, 343
Home Depot, 10, 113, 187, 370, 371, 373, 407, 409
Home Shopping Network (HSN), 376
Honda, 80, 93–94
Honda, Soichiro, 93–94
Hormel, 179, 260

Hostess Brands, 337
HubSpot, 412–413
Hulu, 219, 402
HUSTLE (Humans Uniting to Support the Ladies' Experience), 246

I

Iberdrola, 61
IBM, 153, 187, 230, 322, 345, 427
IKEA, 81, 371, 372
Impossible Foods, 179, 334
Indeed.com, 254
Indiegogo, 152, 487
Inditex, 310
Infosys, 196, 298
Instagram, 35, 42, 43, 97, 254, 318, 380, 403, 404, 408
Intel, 9, 48, 123, 151, 239, 260, 413
Inter-American Development Bank (IDB), 90, 91
International Financial Reporting Standards (IFRS), 444
International Monetary Fund (IMF), 73
International Trade Administration, 89
iPhone, 72
IQVIA, 320
IRI, 320
IRS, 437

J

J. Crew, 11
Jackson, Lisa, 251
Jammet, Nicolas, 207, 208
Jared, 368
JCPenney, 11, 103, 475
JD.com, 376
Jerry's Guide to the World Wide Web, 139
Jet, 371
Jet Blue Airlines, 409–410
Jet Propulsion Laboratory, 269
Jif, 335
J.M. Smucker Company, 335
Jobs, Steve, 192
Joby Aviation, 339
John, Daymond, 158, 187
Johnson, Fisk, 127
Johnson, Kevin, 327
Johnson, Samuel Curtis, 103, 127
Johnson & Johnson, 29, 37, 444
Johnston, Pete, 488, 489
Josephson, Michael, 46
JP Morgan Chase, 476

K

Kaiser Foundation Health Plan, 46
Kansas City Chiefs, 222–223
Kartsotis, Tom, 361
Kay Jewelers, 368
Kayak, 52
KDS Design, 208
Keebler, 337
Kellogg, W. K., 116
Kellogg's, 116, 188, 313
Kempczinski, Chris, 48
Kennedy, John F., 50, 64, 269
KFC, 79, 85, 131, 145, 334
Kickstarter, 152, 416, 487
Kilby, Jack, 219
Kimpton Hotels & Restaurants, 276
King Soopers, 397
Kiva, 409
Kleiner Perkins, 493–494
Klynveld Peat Marwick Goerdeler, 434, 445
Koch, Jim, 339
Kohl's, 367, 371, 372
Koosh Ball, 333
KPMG, 69
Kraft Foods, 484
Kroc, Ray, 111, 112
Kroger, 9, 371, 372, 397, 467
Kumon, 145

L

Lake, Scott, 420
Land O'Lakes, 349
Lands' End, 292, 318, 365
Lapree, Kristin M., 39
LaSalle Network, 262
LED Roadway Lighting Ltd., 76–77
Lee Enterprises, 475
Leesa, 395
Legend BioTech, 484
LEGO, 65, 413, 414
Leissner, Tim, 469
Leslie's, 122
Levi Strauss, 226
Levitan, Eric, 141
Lewis, Michelle, 147
LEXISNEXIS, 318
Lexus, 229
Lincoln Electric, 234
LinkedIn, 5, 253, 254, 255, 273, 404, 408, 414, 416
Liriope Factory, 70
L.L.Bean, Inc., 133, 186
Loads of Hope, 47
Lockheed Martin, 230
L'Oréal, 383
Los Angeles Dodgers, 352
Louis Vuitton, 345
Lowe's, 10, 371, 407, 409
Lütke, Tobias, 420
Luckey, Palmer, 7
Lyft, 102, 136
Lynk, 69

M

M-Pesa, 84, 85
M&Ms, 112
Ma, Jack, 136
Mackey, John, 275
Macy's, 10, 25, 70, 372, 403, 404
Madewell, 60
Maggiano's Little Italy, 218
Magic Bullet, 375
Mailbrew, 41
Manpower, 216
Marathon Oil Corporation, 214
Marimekko, 311
Mark Anthony Brands, 339
Marriott, 319
Mars, Inc., 112, 349
Marshall, John, 111
Martin, Jonathan, 57
Marx, Karl, 17
Mary Kay, 375
Mashable, 404
Maslow, Abraham, 278–279
Massachusetts Institute of Technology, 437
MasterCard, 260, 477
Mattel, Inc., 22
Mayo, Elton, 276
Mayo Clinic, 164
Maytag, 51–52
Mazda, 222
McCartney, Stella, 341
McDonald, Ronald, 198
McDonald's, 13, 48, 58, 111, 112, 145, 147, 149, 198, 259, 314, 344, 382, 473
McFarland, Billy, 38
McGregor, Douglas, 281
McKesson, 37
McKinsey & Company, 250
Me & the Bees Lemonade, 137, 187
Mendive, Jackie, 153
Mercedes-Benz, 229, 233, 344
Mercer, 275
Merck, 61
Meringue Bakery & Cafê, 154
Method Products, Inc., 220
MGM, 407
MGM Resorts, 427
Mi Casa Women's Business Center, 155
Miami Dolphins, 57
Michelin, 344
Microsoft, 5, 26, 34, 112, 125, 136, 158, 202, 211, 260, 289, 292, 293, 315, 342, 344, 427, 458, 459
Microsoft Teams, 293
MicroSolutions, 158
Midas Hospitality, 57
Midvale Steel Company, 276
Milky Way, 112
Mint, 495
Mobileye, 123
Moderna, 219
Mohawk Group, 344
Mojaloop Foundation, 85
Monopoly, 333
Monster.com, 254
Montgomery Ward, 375
Moovit, 123
Morgan Stanley, 122
Motorola, 231
M-Pesa, 84, 85
Mrs. Butterworth, 349
Mrs. Fields Cookies, 9
Musk, Elon, 136, 158, 167, 178, 182, 183
My Med Choices, Inc., 156
Mycoskie, Blake, 139

N

Nadella, Satya, 201
Nasdaq, 485
National Association of Realtors, 381
National Black McDonald's Operators Association, 147
National Center for Employee Ownership, 295
National Pork Producers Council, 381
Native, 306
Neiman Marcus, 11
Neman, Jonathan, 207
Nestlé, 113, 179, 220, 384
Netflix, 219, 261, 304, 402
Neuralink, 178
NeuroMetrix, Inc., 38
New Belgium Brewing, 61, 117
New Therapy Company, 273
New-Wave Fashions, Inc., 191
New York Stock Exchange (NYSE), 485
NextVR, 211
Ng, Chong Hwa (Roger), 469
Nielsen, 318, 320
Nike, 45, 94–95, 112, 166, 198, 287, 341, 344, 374, 411
Nissan, 25, 183
Noom, 151
Nordstrom, 308, 371
North, 125
North Face, 21
Northeast Art Supply, 450, 451, 452, 454, 455, 457
Northrop Grumman Corporation, 230
Noyce, Robert, 219
Nutpods, 137

O

O Magazine, 118
Oculus VR, 416
Odwalla, 53
Office Depot, 373
Office of Management and Budget, 133
Office of Women's Business Ownership, 138

Ogilvy, 385
Olive Garden, 409
Olly, 151
Open Pantry, 372
Oracle, 122–123, 176, 427, 462–463
Orange Therapy, 148
Orbitz, 423
Oreos, 337
Ouchi, William, 282
Owens Corning, 48
Oxi Fresh Carpet Cleaning, 148

P

P. Terry's, 47
Page, Larry, 158, 177
Painting with a Twist, 147
Pair Eyewear, 311
Pampered Chef, 375
Panda Express, 147
Pandora, 75
Panera, 53, 336
Pantene, 107
Park Avenue Furniture, 464
Parker Brothers, 333
Patagonia, 21
Patagonia Works, 117
Patek Philippe, 367
Patreon, 487
Paula's Choice, 318
Paycheck Protection Program, 154
PayPal, 258, 478
Peacock, 219, 402
Pearl Milling Company, 349
Peet, Alfred, 326
Peet's Coffee, 326
Peloton, 140
Pepperidge Farm, 13
Pepperidge Farm Goldfish, 179
PepsiCo, 128, 147, 314, 349, 384
Perdue, 179, 334
Perdue Farms, 38
Periscope, 404
Pet Supermarket, 330
Petco, 330
Peterbrooke Chocolatier, 149
PetSmart, 330, 373
Petty, Herman, 147
Pew Research Center, 260, 403
Pfizer, 79, 122, 219
Philips, 61
Phillip Morris USA, 51
Phillips Corporation, 261
Pichai, Sundar, 123
Pilgrim's Pride, 38
Pinterest, 404, 408
Pizza Hut, 131, 148, 221, 342
Planet Fitness, 145, 348
Planters, 346
Playground Global, LLC, 215
Pledge, 127
Pointy, 211
Polo Ralph Lauren, 374
Pompey, Staci, 138
Pop-Tarts, 343
Porcino, Paul, 496
Postmates, 474
Pottery Barn, 41
Power Solutions, 445
Preysman, Michael, 174
Priceline, 407
PricewaterhouseCoopers, 234, 235, 409, 434
Pringles, 345
Printemps, 372
Procter, William, 107
Procter & Gamble, 29, 41, 47, 103, 107, 127, 153, 188, 190, 336, 342, 345, 355, 367, 383, 482, 486
Propel, 151
Propel Center, 251
Prose, 348
Public Citizen, 53
Public Company Accounting Oversight Board (PCAOB), 445
Publix Super Markets, 295
Pulitzer, Lily, 311
Purdue Pharma LP, 37
Purple, 395

Q

Qdoba, 334
Quaker Oats, 349
QuantuMDx, 134
Quell, 38
Quinn, Robert, 287

R

Ralph Lauren, 158
Real Foodprint, 61
Red Bull, 391
Red Cross, 5
Red Lobster, 409
Red Roof Hotels, 467
Reddit, 408
REI, 292, 365
Renova Medical Wear, 137
RetailMeNot, 389
Rettler Corporation, 39
ReTuna Shopping Centre, 81
Rivian, 102
R.J. Reynolds Tobacco Company, 51
Robinhood, 39
Rocket Mortgage, 477
Rolls-Royce, 311
Ronald McDonald House Charities, 48
Roosevelt, Franklin D., 48
Ross, 373
Ross, Teresa, 45–46
Row 7 Seed Company, 208
Royal Dutch Shell, 113, 444
Ru, Nathaniel, 207

S

Safaricom, 84
Salesforce, 260, 276, 439
Saltgrass Steakhouses, 409
Sam's Club, 172, 324, 371, 373
Samsung, 113, 221, 222, 344, 383
Samsung Galaxy, 314, 335, 341
San Diego Zoo, 391
SAP North America, 417
Sauder Woodworking, 235
Save the Children, 5
SC Johnson Company, 103, 127–128
Schulman, Dan, 258
Schultz, Howard, 327
Schweppe, 85
Scott, Kendra, 138
Scrubbing Bubbles, 127
Securities and Exchange Commission (SEC), 39, 445–446, 456, 468
Selfridges, 372
Selz, 211
Sephora, 315
Serena Ventures, 151
Shamwow, 375
Shark Tank, 139, 187
Shinola Watch Company, 361
Shipt, 431
Shopify, 293, 420
Shout, 127
Showtime, 304, 402
Siegl, Zev, 326
Silve, Nancy, 208
Simply juices, 53
SimplyHired.com, 254
Singer Sewing Company, 146
Singh, Preeti, 406
Skype, 34, 201, 256
Slack, 140, 201, 293
Slater, Samuel, 26
Small Business Administration, 487
Smith, Adam, 14–15, 189
Snapchat, 403, 404, 412
Snickers, 112
Snowdevil, 420
Snowflake, 116
Snuggie, 375
Society for Human Resources Management, 254
SoftBank, 493–494
Sony Corporation, 9, 61, 80, 223, 345
Southern Company, 251
Southwest Airlines, 170, 216, 285–286, 287, 466, 490
Space X, 178
Spaly, Brian, 134
SportClips, 150
Spotify, 75
Sprint, 124
Square, 164
Stankey, John, 168
Stanley Black & Decker, 215, 470–471
Staples, 151, 339
Starbucks, 45, 50, 53, 61, 68, 132, 166, 172, 239, 260, 278–279, 292, 305–306, 326–327, 334, 365, 371, 419, 459, 460
Stars and Stripes Clothing, 473
Stav, Julie, 8
Stewart, Martha, 158, 407
STRAP Surround, 298
Stripe, 140
Stryker, 276
Subway, 148
Sunglass Hut, 374
Sweetgreen, 207–208

T

T-Mobile, 124, 422, 427
Tab, 335
Taco Bell, 131, 149, 254, 272–273
Tallo, 6
Tang, Stanley, 494
Target, 10, 25, 139, 251, 311, 365, 367, 371, 372, 389, 407, 430–431
Tarpenning, Marc, 182, 183
Taylor, Frederick W., 276–277, 281
TBWA Worldwide, 385
Teams, 201
TechJury, 427
Telegram, 404
Tesla, 3, 94, 115, 136, 167–168, 178, 182–183, 435
Theranos, 42
ThousandEyes, 124
Tidal, 75
Tide, 47, 107, 367
TikTok, 319, 380, 391, 403, 404, 406
Tim Hortons, 149
T.J. Maxx, 373
Tokai Seiki, 94
TOMS, 139
Tonal, 151
Topo Chic, 53
TopResume, 286
Touch Up Cup, 139
Toyoda, Kiichiro, 238
Toyota, 19, 25, 94, 113, 191, 222, 228, 230, 238–239, 344, 444
Trader Joe's, 292
Training, 262
TriNet, 262
TripAdvisor, 407
Trump, Donald, 40, 84
Tuft & Needle, 395
Tumblr, 404
Tupperware, 375
Turing Pharmaceuticals, 42
Turkey Hill, 372

Twitch, 404
Twitter, 5, 35, 43, 97, 164, 254, 255, 293, 318, 403, 404, 408, 409, 417
Twix, 112
Tyson Foods, 38, 179, 334

U

Uber, 14, 74, 102, 136, 140, 287, 474, 486
Uber Eats, 327
Ulmer, Mikaila, 137, 187
Ultimate Software, 276
Uncle Ben's, 349
Unilever, 29, 97, 127, 379, 383, 384
United Parcel Service (UPS), 97, 194, 292
Upwork, 385
Urbanek, Terri, 154
U.S. Army War College, 40
U.S. Bureau of Labor Statistics, 291, 318, 370
U.S. Census Bureau, 372
U.S. Commercial Service, 89
U.S. Environmental Protection Agency, 30
U.S. Equal Employment Opportunity Commission (EEOC), 56, 57, 269
U.S. Navy, 180
U.S. Patent and Trademark Office, 342, 344
U.S. Sentencing Commission, 58
U.S. Small Business Administration, 89, 90

V

VeChain, 341
Verizon, 167, 251
Vine, 404
Visa, 484
Viva, 293
Vivo, 141
Volkswagen, 42, 410
Volvo, 223
Vroom, Victor, 284

W

Walgreens, 172, 376, 427, 467
Walgreens Boots Alliance, 371
The Wall Street Journal, 61
Walmart, 9, 10, 11, 25, 103, 122, 128, 134, 172, 214, 228, 311, 330, 339, 355, 364, 371, 372, 421, 423, 444, 481
Walsh, John, 40
Walton, Sam, 11, 122, 481
Wang, Vera, 158
Warburton, Elaine, 134
Warby Parker, 140, 365
Waymo, 102
Webex, 34, 136, 201
Wegmans, 187, 276
Weight Watchers, 346
Weinand, Daniel, 420
Well Yes Soups, 219
Wells Fargo, 39, 42
Wendy's, 147, 395
Whole Foods, 65, 151, 187, 275
Whole Planet Foundation, 65
Wikipedia, 408
Wilkinson, Clive, 297
Williams, Liz, 131
Williams, Serena, 151
Williams-Sonoma, 41
Wilson Sporting Goods, 224
Windex, 127
Winfrey, Oprah, 97, 118, 136
Wing, 376
Wix, 420
Wong, Belinda, 68
WooCommerce, 420
Workday, 173, 276
Working Mother, 292
Workplace Bullying Institute (WBI), 57
World at Work, 275
World Economic Forum (WEF), 341
World Federation of Advertisers (WFA), 322
Wrangler, 341
Wyndham Hotel Group, 407

X

Xerox, 345
XJet, 215
Xu, Ashley, 406
Xu, Tony, 494

Y

Yahoo! 35, 139–140
Yahoo! Finance, 458
Yang, Jerry, 139–140
Yelp, 52, 404, 407
Yoo, Tae, 62
Yoplait, 78
YouTube, 42, 94, 403, 404, 407, 408, 417
YouTube Music, 75
Yrizarry, Magda, 251
Yuan, Eric, 34, 136
Yum! Brands Inc., 131

Z

Zappos, 208, 307, 309, 416
Zara, 310, 341
Zebco, 478
Zenefits, 262
Zillow, 293
Zipcar, 311
ZocDoc, 140
Zoom, 34, 136, 140, 256, 293
Zoox, 102
Zuckerberg, Mark, 136, 158
Zucknet, 158

Subject Index

Numbers

3D printing, 215
20 Days of Giving campaign, 128
20th-century economy, 27
21st-century economy, 28
360-degree evaluation, 266

A

absolute advantage, 69–70
abusive behavior, 57–58, 64
accessibility, 34
accessibility of transportation, 379
accessory equipment, 332
accountability, 193
accounting
  activities of, 447
  and business plan, 497
  careers in, 447–448
  defined, 444
  ethics in, 445–446
  financial statements, 444
  importance of, 461
  information, importance of, 444
  reform in, 445–446
  social and environmental issues, 453
  software, 438
  types of, 446–447
accounting equation, 449
accounts payable, 452
accounts receivable, 451, 482–483
accumulated depreciation, 451
acquisitions, 124–125, 126
ad hoc committee, 204
adaptability, 104, 141
adaptations, 339
adhocracy culture, 287
adjourning stage of teams, 203
administrative managers, 173, 439–440
advertising
  appropriation, 382–383
  careers, 385
  defined, 380, 393
  effectiveness evaluation, 384
  execution of campaign, 384
  legal considerations, 385–386
  media plan, 383
  message creation, 384
  most effective advertisers, 384
  objectives, 382
  social considerations, 385–386
  steps in campaign development, 382–384, 393
  types of, 381–382, 393
advertising agencies, 384–385
advertising e-business model, 424
advertising platform, 382
advisory authority, 197
advisory positions, 188
aesthetic modifications, 337
affirmative action, 55–56, 269
Affordable Care Act (2010), 268
Africa, 75
African Development Bank (AFDB), 91
Age Discrimination in Employment Act (1967, 1986), 268, 269
agents, 366, 370
airplanes, 379
alcohol use as public health issue, 53
algorithms, 41
alien corporations, 113
allocators, 348
allowance for doubtful accounts, 451
allowances, 357, 358
alternative meat, 334
alternatives
  in decision-making, 180
  to job specialization, 190
Amendments to the Equal Credit Opportunity Act (1976, 1994), 54
American Management Association, 426
American Marketing Association, 304
American National Standards Institute (ANSI), 231
American Pet Products Association, 330
American Recovery and Reinvestment Act (2009), 59
Americans with Disabilities Act (1990), 268, 270
analytic skills, 174
analytical process, 214
analytical reasoning, 318
Andon Cord, 239
angel investors, 151, 487
annual reports, 449
antitrust laws, 52
appendix component, business plan, 145, 498
appliances, 222
applications, employment, 255–256
applied research, 219
appraisal errors, 265
April Fools' prank, 410
articles of incorporation, 113–114
articles of partnership, 108
artificial intelligence (AI), 30, 319
  bias in, 46, 322, 437
  and distribution, 368
  replacing managers, 176
  and tax collection, 437
Ascent, 155
Asia, 75
Asian Development Bank (ADB), 91
assembly line, 224
assessment centers, 257
assets, 449, 451–452
Association of Certified Fraud Examiners (ACFE), 448
Association of Chartered Certified Accountants (ACCA), 453
Association of Southeast Asian Nations (ASEAN), 88
attrition, 267
audited financial statements, 444, 461
audits, 444, 446
augmented reality (AR), 30
authoritative leadership, 177
authority
  defined, 193
  types of, 197–198
autocratic leadership, 177, 181
automated teller machines (ATMs), 478
automation, 222, 234, 237
autonomous vehicles, 218

B

B Corp certification, 117
Baby Boomers, 411
balance of payments, 73, 83
balance of trade, 20, 70–73
balance sheets, 449–451, 461
bank draft, 77
banker's acceptance, 479
bankruptcies, 11, 467–468
banks, 492
  international banking, 479–480
  investment banking firms, 484–485
  traditional banking services, 475–477
Banque Africaines de Development, 91
barter, 152
basic research, 219
behavior modification, 290, 296
benchmarking, 230, 417
benefits, employee. *See* employee benefits
benefits-to-the-community component, business plan, 99, 145
best companies to work for, 170, 276, 292
bias in AI algorithms, 46, 322, 437
big data, 317, 319
Big Tech, 211
bill of lading, 77
Blast! Then Refine decision-making, 180
blockchain, 30
blogs, 405–406, 417
Blue Jeans Go Green program, 60
board of directors, 114–115
bond indentures, 490
bonds, 489–491
bonuses, 259
branches, 77
brand association, 344
brand awareness, 344
brand equity, 344
brand extensions, 345
brand insistence, 343
brand loyalty, 343, 344
brand marks, 342

brand names, 342
brand preference, 343
brand recognition, 343
branding
  benefits of, 343–344
  importance of, 359
  strategies, 345
  targeting customers, 411
brands, 342
  choosing and protecting, 344
  defined, 359
  top ten most valuable, 344
  types of, 342–343
breakeven analysis, 352
breakeven quantity, 351
Brewing the American Dream program, 339
Brexit, 87
bribes, 40, 85, 469
brokers, 370
budgets
  capital, 474
  cash, 473
  defined, 473
  personal, 454
  zero-base, 474
building skills for career success, 35, 65, 94, 128, 159, 183–184, 208–209, 239–240, 273, 298, 327–328, 361–362, 385–386, 431–432, 463–464, 495
bullying, 57, 65
bundle pricing, 355
business
  changing world of, 4–9
  choosing, 97, 99
  defined, 9, 28, 102
  development of, 26–27
  e-business. *See* e-business
  environments, 28–31
  ethics. *See* ethics
  manufacturing businesses, 9
  marketing intermediaries, 9
  in mixed economy, 16
  profit, 11–12
  public responsibilities of, 51–55
  reasons to study, 5–8
  response to environmental concerns, 60–62
  responsibilities to employees, 55–56
  risks, 12
  satisfying needs, 10–11
  service businesses, 9
  social media, use of, 403–405
  starting, 7
  text features for students of, 8–9
  today in U.S., 26–32
  types of, 9
business analysis, 340, 359
business balance sheet, 450
business buying behavior, 322, 324
business cycle, 20–22
business ethics, defined, 38, 63. *See also* ethics
business loans, 476
business models, 429
  advertising e-business, 424
  business-to-business (B2B), 422–423
  business-to-consumer (B2C), 423–424
  consumer-to-business, 424
  consumer-to-consumer, 424
  defined, 422
  subscription and pay-per-view e-business, 424
business ownership
  aspects requiring legal help, 113
  corporations. *See* corporations
  joint ventures, 79–80, 121–122, 126
  limited liability companies (LLCs), 119–120, 126
  not-for-profit corporations, 120–121, 126
  partnerships, 107–111
  pride of ownership, 104, 109
  S corporations, 119, 126
  sole proprietorship. *See* sole proprietorships
  special types of, 118–121, 126
  syndicates, 122
  transfer of, 116
  types of, percentages, 103
business plan
  appendix component, 145, 498
  benefits to the community, 99, 145
  building, 161
  choosing a business, 97, 99
  company and industry component, 145, 161
  components of, 97–99, 145
  critical risks and assumptions component, 498
  defined, 144
  executive summary, 498
  exit strategy, 497
  financial plan component, 497
  human resources component, 301
  importance of, 144, 157
  information and accounting component, 497
  introduction, 99
  management team component, 242
  manufacturing component, 242–243
  marketing plan component, 398–399
  operations plan component, 242–243
  purposes of, 144, 157
  review of activities, 99, 161, 243, 301, 399, 498
  steps in, 98
business products
  classifications of, 332
  defined, 331
  distribution channels, 365
  pricing, 357–358, 360
business reports, 442
business services, 332
business-to-business (B2B) markets, 310
business-to-business (B2B) model, 422–423
business-to-business (B2B) products, 331
business-to-consumer (B2C) model, 423–424
buying as marketing function, 305
buying allowances, 390
buying behavior, 325–326
  business buying behavior, 322, 324
  consumer buying behavior, 322–324
  defined, 322
buying power, 21, 323
buyouts, 267

C

C corporation. *See* corporations
cafeteria plans, 261
California, privacy protection, 426
Canada, 74
capacity, 222, 225
capital
  for corporations, 115–116
  debt capital, 475
  defined, 13
  equity capital, 475
  for partnerships, 109
  for small businesses, 142, 143
  sources of, 151
capital budget, 474
capital-intensive technology, 223
capitalism
  defined, 14
  fundamental issues, 15
  in the U.S., 15–17
captioned photographs, 392
captive pricing, 356
career fairs, 254
careers
  in accounting, 447–448
  in advertising, 385
  in business, 5
  choosing, 5
  employer vetting, 286
  as entrepreneurs, 136
  in financial management, 469–470, 474
  in market research, 318
  in operations management, 214–215
  in product management, 338
  researching, 35, 66, 95, 128, 159, 184, 209, 240, 273, 299, 328, 362, 386, 432, 464, 495
  salaries, 5
  virtual, 202
  and workplace diversity, 6
carriers, 378
cash, 478
cash budget, 473
cash deficit, 453
cash discounts, 357, 358
cash flow, 456–458, 461, 470
cash surplus, 453
catalog marketing, 375
category killers, 373
caveat emptor, 48
Central American Free Trade Agreement (CAFTA), 88
centralized organizations, 194
certificate of deposit (CD), 475
certified fraud examiners (CFEs), 448
certified public accountant (CPA), 448
chain of command, 187–188
chain retailers, 371
change in business world, 4–9
charismatic leadership, 177–178, 181
checking accounts, 6
checks, 478
chief ethics officer, 45, 46
chief financial officer (CFO), 474
Children's Online Privacy Protection Act (2000), 54
China
  communism, 17
  discretionary income, 324
  economic outlook for trade, 75
  investment in entrepreneurs, 69
  manufacturing in, 213
  research and development (R&D), 234
  Starbucks in, 68
  trade war with, 84
choice, consumer right to, 52
churn rate, 304, 402
Cigarette Labeling Act (1965), 54
circular business models, 341
circular economy, 81
circular flow, 16, 17
Civil Rights Act (1964), 55
Civil Rights Act (1991), 268, 269
civil rights acts, 268–269
clan culture, 287
classroom teaching, 263
Clayton Antitrust Act (1914), 49
Clean Air Act Amendments, 59
closed corporations, 112
closing the sale, 387

closure of sole proprietorships, 104, 105
cloud computing, 427
Coalition of Action on Plastic Waste, 128
codes of ethics, 43, 44–45
cohesiveness, 203
collateral, 476, 480, 482
command economies, 17
commercial paper, 482, 483
commercialization, 340–341, 359
commissions, 259
committees, 204–205, 206
common carriers, 378
Common Market, 87–88
Common Market of the Southern Cone (MERCOSUR), 89
common stock, 114, 485–486, 491
Commonwealth of Independent States, 88
communication skills, 176
communications
  ethical considerations, 41
  informal, 205
communism, 17
community shopping centers, 374
company and industry component, business plan, 145, 161
comparative advantage, 70
comparative advertising, 382
comparison discounting, 356–357
comparison other, 283
compensating balance, 482
compensation, 247, 248, 271
  decisions, 258–259
  defined, 258
  gender gap, 260
  types of, 259–260
compensation system, 258
competition
  in global marketplace, 214
  monopolistic competition, 24–25
  monopoly, 25–26
  oligopoly, 25
  perfect competition, 23
  on price, 348, 359
  pure competition, 23
  and small business, 134–135
  among teams, 203
  types of, 22–23
competition-based pricing, 353, 359
competitive edge, 435
competitive environment, 28
competitive forces, 315
complementary skills, 109
compliance officer, 45, 46
component parts, 332
Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), 89
compressed workweek, 291–292, 296
computer-aided design (CAD), 235
computer-aided manufacturing (CAM), 235
computer technology, 427–428, 438
concentrated market segmentation, 311, 312
concept testing, 340, 359
conceptual skills, 174
conferences, 263
conflict, 118, 203–204
conflict of interest, 40–41
conglomerate mergers, 125
Consumer Bill of Rights, 51
consumer buying behavior, 322–324
consumer confidence index, 20
Consumer Credit Reporting Reform Act (1997), 54
consumer education, 52, 53
consumer markets, 310
consumer price index (CPI), 20
Consumer Product Safety Commission Act (1972), 54
consumer products, 15, 27
  classifications of, 331, 332
  defined, 331
  distribution channels, 365
  pricing. *See* pricing; pricing methods; pricing strategies
consumer sales promotion method, 389
consumer spending, 16
consumerism
  consumer rights, 51–52
  defined, 51, 64
  major forces of, 53
consumers, 15
  basic rights of, 51–52, 64
  Bill of Rights, 51, 64
  expectations, 58
  household members as, 16–17
  informed, 7–8
  payment options, 478
  and small business, 135
  social media marketing to, 411–412
  trade restrictions, effects of, 83
  and waste, 58
consumer-to-business model, 424
consumer-to-consumer model, 424
containerization, 378
contingency plans, 169
continuity, 105, 110–111
continuous improvement, 230
continuous process, 235
continuous quality improvement, 230
contract carriers, 378
contract manufacturing, 79
controlling, 170–171
convenience products, 331
convenience stores, 372
conversion process, 216, 237
convertible bonds, 490
cookies, 425
cooperative advertising, 390
core competencies, 167
core time, 291
corporate bonds, 489–491
corporate charter, 113–114
corporate citizenship, 48. *See also* social responsibility
corporate culture. *See* organizational culture
corporate growth, 122–125
corporate officers, 115
corporate profits, 20
corporate structure, 114–115
corporate veil, 115
corporations
  advantages of, 115–116, 117, 120, 126
  B Corp certification, 117
  conflict within, 118
  corporate charter, 113–114
  corporate citizenship, 50
  defined, 111
  disadvantages of, 117–118, 120, 126
  financing, 475
  formation of, 112–114, 117–118, 119, 126
  government regulation, 118
  lack of secrecy, 118
  management, 114–115, 116
  organizational meeting, 114
  ownership, 112
  paperwork, 118
  percentage of, 103
  sales receipts of, 104
  and social responsibility, 50
  stockholders, 112, 114
  structure, 114–115
  and taxes, 118
  transfer of ownership, 116
corrective action, 170, 171
cost accounting, 447
cost of goods sold, 455–456
cost-based, 351–352
costs
  of financing, 483
  fixed costs, 351
  holding costs, 377
  of information, 440
  of long-term financing, 491
  of selling stock, 484–485
  of social media plan, 418
  stock-out costs, 377
  of transportation, 227, 378
  variable costs, 351
countertrade, 78
coupons, 389
courses in management, 153
COVID-19
  bankruptcies because of, 11
  economic effects, 73
  and e-sales, 419–420
  and financial management, 466, 467
  incentive payments, 259
  and innovation, 142
  and joint ventures, 122
  and online retail, 10
  SBA assistance, 154
  and social media, 409
  and unemployment, 14
  vaccine development, 219
  work-from-home trend, 202
creative selling, 386
credit for partnerships, 109
Credit Card Accountability, Responsibility, and Disclosure Act (2009), 54
Credit Card Liability Act (1970), 54
credit cards, 152, 477–478
crime, internet, 427
crisis management, 409–410
crisis plans, 169
critical risks and assumptions, business plan, 145, 498
cross-functional teams, 198, 201
crowdfunding, 152
crowdsourcing, 183–184, 413
Cultivate a Better World mission, 61
cultural barriers, 85–86
cultural diversity, 6
curbside delivery, 10
currency
  devaluation of, 82
  differences, 84
current assets, 451
current liabilities, 452
current ratio, 460
customary pricing, 355
customer engagement, 319
customer lifetime value (CLV), 306–307, 324
customer orientation, 309
customer relationship management (CRM), 148, 305, 319, 324, 439
customer satisfaction, 230
customer satisfaction score, 418
customer surveys, 385–386
customer-driven production, 236
customers
  departmentalization by, 191
  listening to, 414
  relationships with, 140–141, 305–307, 324
  satisfying needs, 10–11
  targeting, 411
customs duties, 81

D

- data
  - defined, 436
  - and ethics, 322, 425–426
  - external sources, 318, 441
  - versus information, 436, 461
  - internal sources, 317–318, 441
  - knowledge management, 436–438
  - single-source data, 318
  - storage, 441
  - updating, 441
- data analysis, 318
- data mining, 425
- data processing, 442
- database management, 438
- databases, 437, 441, 461
- debenture bonds, 490
- debit cards, 477–478
- debt, ability to pay, 460
- debt capital, 475
- debt financing, 152, 480–483, 488–491, 491
- decentralization, 194–195, 206
- decision making
  - in consumer behavior, 322–323
  - defined, 179
  - ethical, 63
  - ethical guidelines for, 47
  - generating alternatives, 180
  - identifying the problem or opportunity, 179
  - implementing and evaluating, 180–181
  - and information, 435, 437–438, 461
  - selecting alternatives, 180
  - steps in, 179, 181–182
- decision support system (DSS), 437
- decline stage of product life cycle, 335
- deflation, 19
- delegation, 193, 194
- demand, 23, 24
- demand-based pricing, 352–353
- department stores, 372
- departmentalization, 190–192, 206
- dependability of transportation, 378, 379
- depreciation, 451
- depression, 22
- depth of product mix, 336
- design planning, 221, 232, 237
- desired behavior, 290
- desktop publishing, 438
- devaluation, 82
- development and implementation, 219
- diagnostics, 134
- Diamond Producers Association, 368
- diamonds, 368
- differential pricing, 354–355
- differentiated market segmentation approach, 312, 313
- digital distribution, 366–367
- digital manufacturing, 215
- digital payments, 85
- direct channels, 365
- direct investment, 80
- direct mail, 383
- direct marketing, 375–376, 393
- direct selling, 375
- directing, 170
- direct-response marketing, 375
- disabilities, 270
- discount, 357–358
- discount stores, 372
- discretionary income, 324
- discrimination
  - and AI algorithms, 46, 322, 437
  - Equal Employment Opportunity Commission (EEOC), 269
  - minorities, 56
  - in performance appraisal, 265
  - in recruitment, 256
  - in the workplace, 55
- display advertising, 413
- disposable income, 324
- dissatisfaction, 279–280
- dissatisfiers, 280
- distribution
  - channels, 365–367, 392
  - logistics, 376–379
  - market coverage, 367
  - as marketing element, 313, 314–315
  - retailers, 370–376, 393
  - supply chain management, 367–368, 392
  - wholesalers, 366, 368–370, 392–393
- distribution industries, 135
- distributors, 369
- diversity in the workplace, 6, 56, 250–251, 270–271
- dividends, 114, 485
- Do Not Call Implementation Act (2003), 54
- Dodd-Frank Wall Street Reform and Consumer Protection Act (2010), 54, 468, 491
- domestic corporations, 113
- domestic jobs and trade restrictions, 83
- domestic system, 26
- Dominican Republic-Central America Free Trade Agreement (CAFTA-DR), 88
- door-to-door selling, 375
- dot-com boom, 34
- double-entry bookkeeping system, 449
- Dove Campaign for Real Beauty, 379–380
- downsizing, 267
- drafts, bank, 77
- driving assistance systems, 123
- drone delivery, 376
- dual role, 203
- dual-branded franchises, 148
- dumping, 82
- dynamic pricing, 352

E

- early retirement, 267
- earnings statements, 453
- e-business
  - defined, 10, 418, 429
  - ethics, 425–426
  - external forces, 427, 428
  - future challenges, 427–428, 429
  - internal forces, 427, 428
  - models of, 422–424, 429
  - planning, 422
  - profit, 421–422
  - resources, 419
  - satisfying needs online, 419–421
- e-cigarettes, 55
- e-commerce, 69, 418. *See also* e-business
- economic community, 86, 92
- economic environment, 30–31
- economic forces, 315
- economic freedom, 15
- economic indicators, 20
- economic model of social responsibility, 49
- economic performance, 18–19
- economic systems
  - capitalism, 14–17
  - command economies, 17
  - communism, 17
  - differences in, 13
  - key challenges, 31
  - mixed economy, 15, 16
  - service economy, 28
  - socialism, 17
  - types of, 12–14
- economics, 12
- economies, 13, 20
- education, consumer right to, 52, 53
- e-learning, 263
- electric vehicles, 3, 94, 168, 181–182
- electronic business. *See* e-business
- electronic check conversion (ECC), 479
- electronic exchange, 485
- Electronic Funds Transfer Act, 479
- electronic funds transfer (EFT) system, 478–479
- electronic payments, 478
- email marketing, 413
- embargo, 82
- Emerging Leaders Initiative, 153
- employee benefits, 247, 271
  - defined, 260
  - flexible benefit plans, 261
  - Graeter's example, 300
  - and small business, 262
  - types of, 260–261
- employee development, 271
- employee ownership, 295, 296
- employee participation, 230
- employee relations, 247
- employee stock ownership plans (ESOPs), 295, 296
- employee training, 262, 271
- employee turnover, 267, 271
- employees
  - characteristics of, 6–7
  - with disabilities, 270
  - empowerment, 294, 296
  - ethical treatment of, 233
  - hiring by sole proprietorships, 106
  - motivation. *See* motivation
  - participation in quality, 229–230
  - relationships with employers, 140–141
  - safety, 269
  - successful, 6–7
  - supply and demand, 249
- employers
  - abusive behavior, 57–58, 64
  - affirmative action programs, 55–56, 65
  - ethical treatment of employees, 233
  - relationships with employees, 140–141
  - responsibilities to employees, 55–58
  - sexual harassment programs, 57–58, 65
  - training programs, 56–57
  - values, 286
- employment
  - in manufacturing, 213
  - in services, 217
  - small business providing, 134
- employment applications, 255–256
- Employment Retirement Income Security Act (1974), 268
- employment tests, 256
- empowerment, 294, 296
- energy sources, 60–61
- entrepreneurs. *See also* small businesses
  - capital sources, 151
  - characteristics of, 136–138, 157, 158–159
  - defined, 13
  - and digital manufacturing, 215
  - failure of, 143
  - motivations, 137
  - next wave, 14
  - tips for, 136

entrepreneurship, 13
environment
  and accounting, 453
  business response to, 60–62, 64
  energy sources, 60–61
  and fast fashion, 341
  issues, 58–59
  legislation, 59
  offenses, 58
  and packaging, 346
  pollution, 59–60
  responsibilities to, 58–62
  sustainability, 61
  waste, 58, 60
environmental analysis, 316
Equal Credit Opportunity Act (1974), 54
Equal Pay Act (1963), 268
equilibrium price, 23–24
equity capital, 475, 483
equity financing, 151, 491, 492
equity theory, 283–284, 296
esteem needs, 279
ethical behavior, 42–46
ethics
  in accounting, 445–446
  and bribery, 469
  codes of ethics, 43, 44–45
  communications, 41
  companies' role, 44–45
  compliance officer, 45, 46
  conflict of interest, 40–41
  corporate culture, 173
  data ethics, 322
  decision making, 47, 63
  defined, 38
  e-business, 425–426
  factors affecting, 63
  fairness, 38–39
  government's role, 43–44
  guidelines for decision making, 47
  honesty, 38–39
  individual factors, 42
  internet, 425–426
  issues in, 63
  and management, 194
  in manufacturing, 233
  opportunity as factor, 43
  organizational relationships, 39–40
  privacy protection, 426
  and profitability, 250
  racial equity, 251
  and rebranding, 349
  social factors, 42–43
  in social media, 413
  trade associations' role, 44
  whistle-blowing, 45–46
European Economic Community, 87–88
European Union, 74, 87–88
evaluating solutions, 180–181
evaluation techniques, 264–265
event sponsorship, 391
everyday low prices (EDLPs), 355
exchange control, 82
exclusive distribution, 367, 392
executive compensation packages, 40
executive summary, 145, 316, 498
exit strategy, 145, 497
expansion, 22
expectancy theory, 296
expenses, 421–422
expert systems, 438
export-import agent, 77
export-import merchant, 77
exporting
  assistance programs, 89, 93
  defined, 70
  entering international business through, 76–78
  to international markets, 77
  top exporting states, 71
  U.S. exports, 71
express warranty, 347
extended decision making, 322
extended reality (XR), 30
extension and refinement, 219–220
external forces, 428
external recruiting, 254, 255
extinction, 283

F

facilities planning, 223–225, 232, 237
factoring, 483
factors of production, 13
factory system, 26
failures
  management as cause of, 152
  of products, 341–342
  of small businesses, 142, 143, 157
Fair Credit Billing Act (1974), 54, 479
Fair Debt Collection Practices Act (1977), 54
Fair Labor Standards Act (1938), 268
Fair Packaging and Labeling Act (1966), 54
fairness, 38–39
False Claims Act, 45
Family and Medical Leave Act (1993), 268
family branding, 345
family packaging, 346
fashion, 341
fast fashion, 341
feature articles, 392
federal deficit, 22
Federal Hazardous Substances Labeling Act (1960), 54
Federal Trade Commission Act (1914), 49
field order takers, 386
financial accounting, 447
financial data, comparing, 458
financial leverage, 488
financial management
  careers in, 469–470
  importance of, 467–468, 491
  monitoring and evaluating performance, 475
  need for, 468
  planning, 472–475, 492
financial managers, 172, 439
financial plan, 145
  and business plan, 497
  defined, 472
  development of, 472–475
  steps in, 472, 492
financial ratios, 458–460
financial resources. *See also* financing
  defined, 9
  for e-business, 419
  as management resource, 165
financial security, 276
financial services, 492
  consumer payment options, 478
  debit and credit cards, 477–478
  electronic banking services, 478
  international banking, 479–480
  traditional banking, 475–477, 492
financial statements, 444, 458–460
financing
  angel investors, 151, 487
  commercial paper, 482
  for corporations, 115–116
  cost comparisons, 483
  crowdfunding, 152
  debt financing, 152
  equity financing, 151
  long-term, 470, 471, 488–491
  as marketing function, 305
  need for, 470–472, 492
  of partnerships, 109
  private placement, 487
  promissory notes, 481
  secured short-term, 482–483
  short-term, 470–471, 480–482, 483
  Small Business Administration (SBA), 154–155
  for small businesses, 142, 143, 150–152, 157, 487
  in sole proprietorships, 105–106
  sources, identifying, 474
  trade credit, 480–481
  unsecured, 480, 481–482
  venture capital, 151, 486
finished-goods inventory, 227
firing, 267
first-line managers, 172
fiscal policy, 22
fixed assets, 451
fixed cost, 351
fixed-position layout, 224, 225
flat organization, 196
flexibility, 104, 141, 379
flexible benefit plans, 261
flexible manufacturing system (FMS), 235–236, 237
flexible scheduling options, 290–292, 296
flexitarianism, 334
flextime, 291, 296
flotation costs, 484, 491
FOB destination pricing, 357
FOB origin pricing, 357
focus groups, 320
focus of conversion process, 216
follow-up
  as function of scheduling, 229
  in personal selling, 387–388
Food Quality Protection Act (1996), 59
forecasting human resources supply and demand, 248–249
foreign corporations, 113
Foreign Corrupt Practices Act (FCPA) (1977), 40, 85, 469
forensic accounting, 448
form utility, 307
forming stage of teams, 202
forums, 408
fossil fuels, 60
franchise, 145
franchise agreement, 146
franchisees, 145, 146
franchising, 79
  advantages of, 148–149, 157
  defined, 145
  disadvantages of, 149–150, 157
  dual branding, 148
  growth of, 146–147
  people of color in, 147
  and sustainability, 148
  types of, 147–148
  women in, 147
franchisor, 145
fraud, 445–446
free enterprise, 4
free-market economy. *See* market economy
freemium pricing model, 34
free-rein leadership, 177
free trade, 67
French pot manufacturing method at Graeter's, 96
frequency of transportation, 379
frequent-user incentives, 389–390
frozen investment, 111
full-service wholesalers, 369

function, departmentalization by, 190
functional authority, 197–198
functional modifications, 337

G

gainsharing, 259
gender gap, 57, 260
General Agreement on Tariffs and Trade (GATT), 86, 92
general expenses, 456
general managers, 173
general partners, 107, 110
generally accepted accounting principles (GAAPs), 444
general-merchandise wholesalers, 370
Generation X, 411
Generation Z, 6, 411
generations, 411
generic brands, 343
generic products, 343
genetically modified organisms (GMOs), 55
geographic pricing strategies, 357
Get Your Share (Stave), 8
global business. *See* international business; international trade
global environment, 28–29
goals, 166–167, 473
goal-setting theory, 285, 296
goods
  defined, 330
  warehousing, 377
government
  in capitalism, 15
  and ethics, 43–44
  in mixed economy, 17
  regulation of corporations, 118
  and social responsibility, 48–49
government accounting, 447
government markets, 310
grapevine, 205, 206
graphics software, 438
graphs, 442–443
Great Depression, 22, 48, 468
Great Recession, 14, 21
Greatest Generation, 411
green business, 31, 60–62
green IT, 427
green marketing, 61–62
green washing, 62
Greenlist program, 127
gross domestic product (GDP)
  defined, 19
  growth rate, 19
  per capita, 84
gross sales, 454
growth
  of franchising, 146–147
  through mergers and acquisitions, 124–125, 126
  in productivity, 234
  from within, 122–123, 126
growth stage of product life cycle, 334

H

hackers, 426
hands-off leadership, 177
hard skills, 253
hard-core unemployed, 57
hashtag, 404
Hawthorne Studies, 277–278, 296
health of citizens, trade restrictions and, 83
heart disease as public health issue, 53
Herzberg's motivation-hygiene theory, 275, 279–280, 289, 296
hierarchical culture, 288
hiring, 6, 106. *See also* recruitment
hiring parties, 254
holding costs, 227, 377
honesty, 38–39
Horatio Alger Award, 4
horizontal mergers, 124
hostile takeovers, 124
hourly wages, 259
households in mixed economy, 15–16
human factors, 278
human relations, 278
human relations movement, 278
human resources
  defined, 9
  for e-business, 419
  and facilities planning, 223
  leading and motivating, 170
  as management resource, 165, 166
  in sole proprietorships, 106
human resources management (HRM)
  activities, 247
  business plan, 301
  compensation and benefits, 258–262
  components of, 270
  defined, 246
  employee benefits, 260–262
  employee turnover, 267
  job analysis, 252
  legal environment, 267–270, 271
  onboarding, 257
  overview, 246–247
  performance appraisal, 264–266
  planning, 248–249, 270
  recruitment, 253–255, 414
  responsibility for, 248
  selection, 255–257
  training and development, 262–264, 271
  workplace diversity, 250–251
human resources managers, 173, 439
human resources planning, 247
  defined, 248
  forecasting demand, 248–249
  forecasting supply, 249
  matching supply with demand, 249
The Human Side of Enterprise (McGregor), 281
hygiene factors, 280

I

idea generation, 339, 359, 413–414
ideas, 330
identity theft, 427
imitations, 339
immediate-response advertising, 382
immigrants, 139–140
implementing solutions, 180–181
import duties, 81
import quota, 82
importing, 70
inbound marketing, 412
incentive payments, 259
income
  aspects of, 324
  comparative levels, 56
  disparity, 55
  gender differences, 57
income statements, 453–456, 461
incorporation, 112–114
independence of small-business owners, 141
independent retailers, 371
India, 75
individual branding, 345
individual wages, 258–259
industrial markets, 310
industrial products, 331
Industrial Revolution, 26
industries, protecting with trade restrictions, 83
inflation, 19
influencers, 407
informal groups, 205
informal organizations, 205, 206
information
  and business plan, 497
  consumer right to, 51
  versus data, 436, 461
  defined, 436
  and the grapevine, 205
  importance of, 444
  knowledge management, 436–438
  management information system, 438–440
  as management resource, 165
  and marketing, 305, 317–320, 325. *See also* marketing research
  presenting, 442–443
  requirements, 439, 461
  and risk, 435, 461
information resources
  defined, 9
  for e-business, 419
information rules, 436
infrastructure, 84
initial public offering (IPO), 116, 122, 484–485
innovation
  and COVID-19, 142
  defined, 339
  financial services, 477
  and organizational structure, 192
  and small business, 133–134
  Spotify, 75
inputs, 216, 283
input-to-outcome ratio, 283–284
inside order takers, 386
inspection, 230
institutional markets, 310
insurance packages, 260
intangible assets, 452
integrated marketing communications, 393
integrated software, 438
intensive distribution, 367, 392
Inter-American Development Bank (IDB), 91
intermittent process, 236
internal forces, 428
internal recruiting, 253–254
international banking services, 479–480
international business. *See also* international trade
  basis for, 69–76, 92
  challenges, 81–86, 92
  contract manufacturing, 79
  defined, 69
  direct investment, 80
  financing, 90–92, 93
  importance of, 92
  joint ventures and alliances, 79–80
  licensing and franchising, 78–79
  methods of entering, 76–80, 92
  multinational corporations, 80
  steps in entering, 76
International Franchise Association, 149–150
International Monetary Fund (IMF), 91–92
International Organization for Standardization (ISO), 231
international resources, misallocation of, 83–84
international trade
  economic challenges, 84

international trade (*Cont.*)
  economic outlook, 73–75
  facilitators of, 86–89, 92
  legal and political climate, 85
  overview, 68–69
  restrictions, 68, 81–84, 92
  and small business, 156
  social and cultural barriers, 85–86
  top exporting states, 71
  US trade in goods and services, 72
international trade agreements, 87–89
internet. *See also* social media
  advantages/disadvantages, 383
  crime, 427
  as data source, 318–319, 320
  e-business. *See* e-business
  ethics, 425–426
  ethics and, 43
  future challenges, 427–428, 429
  growth potential, 424–425
  as transportation, 379
  usage statistics, 424–425
interpersonal skills, 175
Interstate Commerce Act (1887), 49
interviews
  performance appraisal, 266
  recruitment, 256–257
introduction component, business plan, 145
introduction stage of product life cycle, 333–334
inventory
  as collateral, 482
  merchandise, 451
  types of, 482
inventory control, 227–228, 232, 237
inventory management, 377, 460
inventory turnover, 460
investment. *See also* financing
  angel investors, 151
  direct investment, 80
  frozen investment, 111
investment banking firms, 484–485
investors, 7–8, 151
invisible hand, 14
issue resolution rate, 418
It Can Wait campaign, 55

J

Japan
  economic outlook for trade, 75
  small business start-up, 133
job analysis, 247, 252, 271
job description, 252
job design, 188–190
job enlargement, 289, 290, 296
job enrichment, 289–290, 296
job evaluations, 258
job posting, 253
job redesign, 289, 296
job rotation, 190
job sharing, 292–293, 296
job specialization, 189–190, 206
job specification, 252
jobbers, 369
jobs and trade restrictions, 83
joint ventures, 79, 121–122, 126
judgmental appraisal methods, 264–265
just-in-time inventory (JIT) system, 228, 239

K

Kanban, 239
Kefauver-Harris Drug Amendments (1962), 54
Kennedy Round, 86
key performance indicators (KPIs), 417
knowledge management (KM), 436–438, 461

L

labeling, 347
labor, 13
labor force component, business plan, 145
labor unions, 48
labor-intensive technology, 222
Labor–Management Relations Act (1947), 268
laissez-faire capitalism, 15
laissez-faire leadership, 177, 181
land, 13
landfills, 58, 60
Latin America, 74
lay-offs, 267
leadership
  best style, 178–179
  defined, 176
  formal and informal, 176–177
  styles of, 177–178
  types of, 181
leading, 170
lean manufacturing, 234
lectures, 263
legal and political climate, 85
legal and regulatory forces, 315
legislation
  affecting business, 48–49
  affecting human resources management, 268
  business regulation, 49
  and consumer protection, 53–54
  environmental, 59
letters of credit, 77, 479
liabilities, 449, 452
liability
  limited, 115
  in partnerships, 107, 110
  in sole proprietorships, 105
  unlimited, 105, 110
licensing, 78–79
life cycle assessment (LCA) framework, 220
lifestyle shopping centers, 374
limited decision making, 322
limited liability, 115
limited liability companies (LLCs), 119–120, 121, 126
limited liability partnership (LLP), 110
limited monopoly, 26
limited partners, 107, 110
limited potential, 142
limited-line retailers, 373
limited-line wholesalers, 370
line authority, 197
line extension, 345
line managers, 197–198, 248
line of credit, 476
line structure, 196–197, 206
line-and-staff structure, 197–198, 206
liquidity, 451
listening
  to customers, 414
  to stakeholders, 410–411
load flexibility, 379
loans, 476, 481–483, 488–489. *See also* financing
location, departmentalization by, 191
logistics
  activities of, 393
  defined, 376
  inventory management, 377
  materials handling, 378
  order processing, 377
  transportation, 378
  warehousing, 377
long-term debt financing, 488–491
long-term financing, 470, 471, 476, 488–491
long-term liabilities, 452
long-term loans, 488–489, 491
loss, 11, 453
lump-sum salary increases, 259

M

macroeconomics, 13
magazines, 383
magnitude of change, 216
major equipment, 332
major resources, 216
make to order system, 236
Malcolm Baldrige National Quality Award, 229
malpractice, 110
management
  areas of, 439
  and business plan, 144
  controlling function of, 170–171
  in corporations, 114–115
  decision making, 179–181
  defined, 164, 181
  disagreements, 110
  and ethics, 194
  first-line managers, 172
  functions of, 165–171, 181
  leading function of, 170
  levels of, 171–172
  motivating function of, 170
  organizing function of, 169–170
  planning function of, 165–169
  process of, 166
  resources of, 165
  sales management, 388, 393
  SBA management assistance, 152–154
  and small business, 143
  span of, 195–196, 206
  specialized, 116, 172–173
  women in, 172
management by objectives (MBO), 288–289, 296
management courses, SBA, 153
management development, 262, 271
management information system (MIS)
  costs, 440
  data collection, 441
  data storage, 441
  data updates, 441
  defined, 438
  functions of, 440, 461
  limits, 440
  presenting information, 442–443
management skills, 106
management team component, business plan, 145, 242
managerial accounting, 446
managers
  administrative managers, 173, 439–440
  characteristics of, 177
  financial managers, 172, 439
  general managers, 173
  human resources managers, 173, 439
  key skills of, 174–176, 181
  kinds of, 171–173
  leadership role, 176–179
  levels of, 181
  line managers, 197–198
  marketing managers, 173, 439
  middle managers, 172
  operations managers, 173, 439
  project managers, 198
  staff managers, 197–198
  top managers, 171–172
manufacturer brands, 342
manufacturer's agents, 370

manufacturing
  business plan, 242–243
  computer systems, 235
  digital, 215
  ethics in, 233
  flexible manufacturing system (FMS), 235–236
  resilient, 220
  and sustainability, 233
  in the U.S., 212–214, 215
manufacturing and operations plan, 145
manufacturing businesses, 9
market coverage, 367
market culture, 288
market demand, 225
market economy, 15
market measurement, 317
market price, 23–24
market segmentation, 311, 313
market share, 315, 350
marketable securities, 451
marketing
  and buying behavior, 322–324, 325
  and customer relationships, 305–307
  defined, 304, 324
  digital, 411–413
  direct marketing, 375–376
  functions of, 305
  information, 317–320, 325
  market measurement, 317, 325
  mobile marketing, 418–419
  multiple channels, 366
  objectives, 316
  sales forecasting, 317, 325
  and social media, 411–413, 415
  strategies, 310–316
  targeting customers, 411
  test marketing, 340
  value added by, 307–308, 324
marketing analytics, 319, 325
marketing channels, 365, 392
marketing concept
  defined, 308
  development of, 324–325
  evolution of, 308–309
  implementation of, 309–310, 324–325
marketing environment, 314, 315–316, 325
marketing implementation, 316
marketing intermediaries, 9, 365
marketing managers, 173, 439
marketing mix, 310, 313–315, 325
marketing plan, 145, 316–317, 325, 398–399
marketing research
  as career, 318
  defined, 320
  overview, 320–321
  primary data, 320
  secondary data, 320, 321
  steps in, 321
marketing strategies
  as component of marketing plan, 316
  defined, 310
  market segmentation approach, 311, 313
  and marketing environment, 315–316
  marketing mix, 313–315, 325
  target market, 310–313, 325
  undifferentiated approach, 311
marketing-communications mix, 380
markets, 310, 325
markup, 351
Maslow's hierarchy of needs, 275, 278–279, 296
mass production, 214
material requirements planning (MRP), 227–228
material resources, 9
  for e-business, 419
  as management resource, 164
materials handling, 378
matrix structure, 198–199, 206
mattresses, 394–395
maturity date, 490
maturity stage of product life cycle, 335
Mayo's Hawthorne Studies, 275
McGregor's Theory X and Theory Y, 275
meat, alternative, 334
Meat Inspection Act (1906), 49
media classifications, 383
media conferences, 392
media plan, 383
media sharing sites, 406–407
mentors, 262–263
merchandise inventory, 451
merchant wholesalers, 369–370
mergers, 124–125, 126
merit pay, 259
Mexico, 74
microchips, 219
microeconomics, 12
microloan program, 155
Middle East/North Africa, 75
middle managers, 172
middlemen, 365, 366
Millennials, 411
minorities. *See also* people of color; women
  discrimination, 55
  income disparity, 55, 56
  support for, 155
Minority Business Development Agency (MBDA), 155
mission, 166
missionary salespersons, 386
mixed economy, 15, 16
mobile marketing, 418–419
mobile payments, 478
monetary policies, 22
monopolistic competition, 24–25
monopoly, 25–26
morale, 276
mortgage bonds, 490
mortgage payable, 452
most-favored-nation status (MFN), 86
motivating, 170
motivation
  contemporary views of, 283–285, 296
  defined, 275
  factors affecting, 280
  historical perspectives on, 276–283, 296
  hygiene factors, 280
  importance of, 296
  organizational culture, 285–288
  techniques, 288–295, 296
motivation-hygiene theory, 279–280
motive, 275
Motor Vehicle Safety Act (1966), 54
multibase departmentalization, 191, 192
multichannel distribution, 366
multichannel retailing, 371
multilateral development bank (MDB), 91
multinational corporations, 80
multiple market channels, 366
multiple-unit pricing, 355

N

narrow span of management, 195–196
national debt, 22
National Environmental Policy Act (1970), 59
national income, 20
National Labor Relations Act (1935), 268
national security, 83
nations
  economic indicators measuring economy of, 20
  economic systems of, 12–17
natural monopoly, 26
natural resources, 13
needs
  defined, 278
  satisfying, 10–11, 28
  satisfying online, 419–421
negative reinforcement, 283
negligence, 110
negotiated pricing, 354
neighborhood shopping centers, 374
net income, 456
net loss, 456
net profit margin, 459–460
net sales, 454
net worth, 450
network organization, 199
new housing starts, 20
new-product development, 339–341
new-product pricing, 353–354
news releases, 392
newspapers, 383
Noise Control Act (1972), 59
nonparticipant role, 203
non-price competition, 348, 359
nonstore retailing, 374
nontariff barriers, 82
norming stage of teams, 202
North American Free Trade Agreement (NAFTA), 87
North Korea, 17
notes payable, 452
notes receivable, 451
not-for-profit accounting, 447
not-for-profit corporations, 120–121, 126
Nutrition Labeling and Education Act (1990), 54

O

obesity as public health issue, 53
objective appraisal methods, 264
objectives
  advertising, 382
  business, achieving through social media, 408–414
  defined, 166–167, 473
  management by objectives (MBO), 288–289, 296
  marketing, 316
  pricing, 349–350, 359
  sales promotion, 388, 393
  of social media plan, 414–415
  and strategic planning, 166–167
Occupational Outlook Handbook (Department of Labor), 447, 469
Occupational Safety and Health Act (1970), 268, 269
odd-number pricing, 355
off-price retailers, 373
Oil Pollution Act (1990), 59
oil spills, 60
oligopoly, 25
omnichannel distribution, 366
on-the-job training, 263
onboarding, 247, 257, 271
ongoing costs, 484, 491
online retail, 10, 370–371
open corporations, 112
open-source software, 85
operating expenses, 456
operational planning, 225–226, 232, 237
operational plans, 168, 169

operations control, 232
  aspects of, 226
  inventory control, 227–228
  purchasing, 226–227
  quality control, 229–231
  scheduling, 228–229
operations management, 212, 214, 242–243
operations managers, 173, 212, 439
opioid crisis, 37
opportunity, 43
optimization, 167
order getters, 386
order processing, 377
order takers, 386
organization chart, 187, 188–189, 208
organizational buyers, 366
organizational culture, 173, 175, 285–288, 296, 297–298
organizational height, 196
organizational relationships, ethics relating to, 39–40
organizational structure
  forms of, 196
  line-and-staff structure, 197–198
  line structure, 196–197
  matrix structure, 198–199
  virtual structure, 199
organizations
  decentralization of, 194–195
  defined, 186, 206
  delegation, 193, 194
  departmentalization, 190–192
  informal, 205, 206
  job design, 188–190
  organizational height, 196
  structures, 196–199, 206
organized effort of individuals in a business, 9–10
organizing, 169–170
orientation, 257
Ouchi's Theory Z, 275
outcomes, 283
out-of-home advertising, 383
outside order takers, 386
outsourcing, 79, 419
over-the-counter (OTC) markets, 485
owners' equity, 449, 452, 483

P

packaging
  defined, 345
  design considerations, 346
  environmentally conscious, 306
  factors affecting, 359
  functions of, 345–346, 359
  and market share, 335
parental leave, 246
participative leadership, 177, 181
partnerships
  advantages of, 109, 117, 125–126
  defined, 107
  disadvantages of, 110–111, 117, 125–126
  partnership agreement, 108, 125
  percentage of, 103
  sales receipts of, 104
  and taxes, 109
  types of, 107, 125
part-time work, 292, 296
party plan, 375
passbook savings account, 475
patents, 452
pay for time not worked, 260
peak period of business cycle, 21
penetration pricing, 354
pension and retirement programs, 260
people of color
  in business, 4, 147, 172
  Everlane scandal, 173
  and franchising, 147
  gender pay gap, 260
  as percentage of workforce, 250
  racial equity, 251
people skills, 175
per capita GDP, 84
perceived brand quality, 344
perfect competition, 23
performance appraisal, 247, 248, 264–266, 271
performance evaluation, 316
performance feedback, 266, 271
performance feedback interview, 266
performance management, 264
performance measuring, 170, 171
performing stage of teams, 203
periodic discounting, 354
perpetual life, 116
personal balance sheet, 450
personal budget, 454
personal income, 324
personal income statement, 454
personal interest, 109
personal selling, 380, 386–388, 393
personal selling process, 387–388, 393
personnel management. *See* human resources management (HRM)
photographs, 392
photos, 406–407
physiological needs, 278
piece-rate system, 277
piggyback transportation, 379
pipelines, 379
place utility, 307
plagiarism, 40
planned shopping centers, 373
planning
  defined, 165
  and e-business, 422
  and financial management, 472–475
  goals and objectives, 166–167
  of human resources, 248–249, 270
  marketing plan, 316–317, 325
  operational, 225–226
  production, 221–226, 231–232
  of services, 217
  and small business, 143, 144
  strategic planning process, 166
  SWOT analysis, 167
  types of plans, 167–169, 181
planning horizon, 225
plans, 167
plant layout, 224–225
podcasts, 407
point-of-purchase displays, 390
point-of-sale (POS) terminals, 479
political forces, 315
pollution, 59–60
positive reinforcement, 283
possession utility, 307
The Post-Industrial Society (Drucker), 362
potential of small businesses, 142
preferred stock, 114, 486, 491
pregnancy, 270
premium pricing, 356
premiums, 389
prepaid expenses, 451
presentations, sales, 387
press conferences, 392
price
  buyers' perceptions of, 349, 359
  defined, 347
  as marketing element, 313, 314
  in maturity stage, 335
  meaning and use of, 347–348
  as purchasing factor, 227
price competition, 348, 359
price differentiation, 352
price floor, 351
price leaders, 356
price lining, 356
price skimming, 354
pricing
  of business products, 357–358, 360
  economic basis of, 359
  objectives, 349–350, 359
pricing methods
  breakeven analysis, 352
  competition-based, 353, 359
  cost-based, 351–352, 359
  demand-based, 352–353, 359
pricing strategies, 356
  defined, 353
  differential pricing, 354–355
  new-product pricing, 353–354
  product-line pricing, 356
  promotional pricing, 356–357
  psychological pricing, 355
  types of, 353, 359
pride of ownership, 104, 109
primary data, 320
primary markets, 484–485
primary-demand advertising, 381
prime interest rate, 20, 481
Principles of Criminology, 448
privacy, 85, 322, 426
private accountants, 447
private brands, 342
private carriers, 378
private placement, 487
private warehouses, 377
problem recognition, 323
problems, 179
problem-solving feedback interview, 266
problem-solving teams, 200
process layout, 224
process materials, 332
producer brands, 342
producer markets, 310
producer price index (PPI), 20
product deletion, 338–339
product design, 221–222
product differentiation, 24–25, 348
product layout, 224
product life cycle
  defined, 333
  stages of, 333–335, 358
  using, 336
product line, 221, 336, 358
product managers, 338
product mix
  defined, 336, 358
  existing products, 337
  failed products, 341–342
  managing, 336–342, 358–359
  new products, 339–341
  product deletion, 338–339
product modification, 337
production
  adjusting to meet demand, 225–226
  conversion process, 216, 237
  facilities planning, 223–225
  nature of, 236
  overview, 212
  planning, 221–226
  site selection, 223
production capacity, 222
production industries, 135
production orientation, 308
production planning, 231–232, 237
production processes, 216, 237

productivity
  computer manufacturing systems, 235
  defined, 17
  growth, 234
  growth, effects of, 18–19
  growth rates, 232, 233
  improvement, 17, 19
  and sustainability, 236
  and technological displacement, 236, 237
  and technology, 232–236, 234–236
  trends in, 232
product-line pricing, 356
products
  business product pricing, 357–358, 360
  classifications of, 331–332, 358
  consumer, 15
  defined, 330, 358
  departmentalization by, 191
  and ethics, 233
  extension and refinement, 219–220
  idea generation, 413–414
  as marketing element, 313, 314
  origins, 218
  packaging, 306, 335
  research and development (R&D), 219
profit
  ability to earn, 459–460
  corporate profits, 20
  defined, 11, 453
  in e-business, 421–422
  as household income, 16
  maximization, 350
  negative, 11
  in partnerships, 109
  and sales revenue, 11
  in sole proprietorships, 104
  and sustainability, 61
profit sharing, 260
project managers, 198
promissory notes, 481, 483
promotion (career), 267
promotion (marketing)
  advertising. *See* advertising
  defined, 380
  Dove, 379–380
  integrated marketing communications, 379–380
  as marketing element, 313, 315
  personal selling, 386–388
  public relations, 381, 390–392
  sales promotion, 388–390
promotion mix, 380–381, 393
promotional pricing, 356–357
prospecting, 387
protective tariffs, 81
prototypes, 340
proxy, 114
psychological pricing, 355
public accountants, 447
public health, businesses' responsibility to, 53, 55
public relations, 381, 390–392, 393
public responsibilities of business, 64. *See also* social responsibility
  consumerism, 51–52, 64
  to employees, 55–58
  to the environment, 58–62, 64
  public health, 53–55
public warehouses, 377
publications, SBA, 154
publicity, 391–392
pull policy, 381
punishment, 283
purchasing, 226–227, 232, 237
pure competition, 23
Pure Food and Drug Act (1906), 49
push policy, 381

Q

qualifying sales prospects, 387
qualitative social media measurement, 417–418
quality as purchasing factor, 227
quality circle, 230
quality control, 232, 237
  defined, 229
  and employee participation, 229–230
  International Organization for Standardization (ISO), 231
  Six Sigma, 231
  total quality management (TQM), 230–231
quality modifications, 337
quantitative social media measurement, 416–417
quantity discounts, 357, 358

R

racial equity, 251
Racial Equity and Justice Initiative (REJI), 251
rack jobbers, 370
radio, 383
radio frequency identification (RFID), 378
railroads, 379
random discounting, 354–355
rating scales, 265
raw material, 332
raw materials inventory, 227
realistic job previews (RJPs), 255
reasonable accommodation, 270
rebates, 389
rebranding, 349
recession
  of 2008, 14, 21
  defined, 21
  worldwide, 73
recognition
  giving, 291
  need for, 276
record keeping, 141
recovery, 22
recruiting, 247
recruitment, 116, 248. *See also* hiring
  defined, 253
  external, 254
  internal, 254
  process of, 253–255, 271
  via social media, 254, 414
recycling, 60
reference pricing, 355
references, 257
refinement, 219–220
registered bonds, 489
regular corporation. *See* corporations
reinforcement, 282
reinforcement theory, 282–283, 296
relationship marketing, 305
relationship orientation, 309
reliability as purchasing factor, 227
reminder advertising, 382
replacement chart, 249
reputation management, 409–410
RESCUE (REinforce Supply Chain Under Emergency), 239
research and development (R&D), 211, 219, 232, 234, 237, 340
reseller markets, 310
reshoring, 214
resolution time, 418
Resource Conservation and Recovery Act (1984), 59
Resource Recovery Act (1970), 59
resources
  combining, 9
  of conversion process, 216
  for e-business, 419
  financial resources, 9
  human resources, 9
  information resources, 9
  material resources, 9
responsibility, 193
résumés, 255
retail, 10
retailers
  defined, 366
  as distribution channel, 135, 366
  and financing, 305
  multichannel, 371
  nonstore retailing, 374–376
  number of, 370
  online, 370–371
  as reseller market, 310
  shopping centers, 373–374
  size of industry, 370
  ten largest, 371
  types of, 371–373, 393
retained earnings, 452, 486
return on investment (ROI), 350, 359
return on sales, 459–460
revenue tariffs, 81
revenues, 454
reverse discrimination, 56
revolving credit agreement, 476
rights
  to be heard, 52
  to be informed, 51
  to choose, 52
  to consumer education, 52
  of consumers, 51–52, 64
  of franchisees, 146
  to safety, 51
  to service, 52
rightsizing, 249
risk
  of business ownership, 12
  and information, 435
risk-return ratio, 471–472, 490
risk taking as marketing function, 305
robotics, 234–235, 237. *See also* artificial intelligence (AI)
role-playing, 263
routine decision making, 322

S

S corporations, 119, 120, 126
safety
  consumer right to, 51
  employees', 269
safety needs, 278
salaries
  defined, 259
  and education, 5
salaries payable, 452
sales agents, 370
sales allowances, 454
sales discounts, 454
sales forecasting, 317, 325
sales management, 388, 393
sales offices, 77
sales orientation, 308
sales promotion, 381
  defined, 388
  methods, 389, 393
  objectives, 388, 393
  selection of methods, 390
sales returns, 454
sales revenue
  in e-business, 421
  and profit, 11
sales support personnel, 386
salespersons, 386–387, 393
samples, 389
Sarbanes-Oxley Act (2002), 43–44, 45, 46, 446, 448

satisfaction, 279–280
satisfice, 180
satisfiers, 280
savings accounts, 475
SBA International Trade Loan program, 156
scarcity, 12
scheduling, 228–229, 232, 237
scientific management, 276–277
SCORE, 153
screening in product development, 339, 359
search engine marketing, 413
search engine optimization, 413
seasonal discounts, 357, 358
secondary data, 320, 321
secondary markets, 485
secondary-market pricing, 354
secured loan, 483
securities exchange, 485
segmenting and targeting social media customers, 415
selection of job applicants, 247, 248, 255–257, 271
selective distribution, 367, 392
selective-brand advertising, 381–382
selective-demand advertising, 381–382
self-actualization needs, 279
self-managed teams, 200
selling
  as marketing function, 305
  online, 370–371
  stock, 484–486
selling expenses, 456
seminars, 263
sense of involvement, 278
serial bonds, 490
service, consumer right to, 52
service businesses, 9
Service Corps of Retired Executives (SCORE), 153
service economy, 28, 217
service industries, 135, 217
services
  defined, 330
  differences from manufactured goods, 218
  employment in, 217
  importance of, 217, 237
  origins, 218
  planning, 217
  quality of, 218
sexual harassment programs, 57–58
Sherman Antitrust Act (1890), 49
shipping costs as purchasing factor, 227
shopping centers, 373–374, 393
shopping products, 331
short-term debt financing, 480–483, 492
short-term financing, 470–471, 476, 480–482, 483
short-term secured financing, 482–483
Silent Generation, 411
simulations, 263
single-line retailers, 373
single-source data, 318
sinking funds, 490
site selection, 223, 232
Six Sigma, 231
skills
  in-demand, 253
  hard, 253
  management, 181
  managerial, 174–176, 177
  soft, 175, 253
skills inventory, 249
Small Business Administration (SBA), 132, 138, 151, 157
  financial assistance, 154–155
  help for global markets, 156
  help for minority-owned small businesses, 155
  management assistance, 152–154
  publications, 154
Small Business Saturday, 106
small businesses. *See also* Small Business Administration (SBA)
  advantages of, 140–141, 157
  business plan, 144
  closure statistics, 143
  and competition, 134–135
  defined, 132
  disadvantages of, 142–143, 157
  distribution industries, 135
  employee benefits, 262
  as employers, 134
  failure of, 142, 143, 157
  failure rate, 7
  filling societal needs, 135
  financing, 150–152, 157, 487
  and global markets, 156, 157
  immigrants as owners, 139–140
  importance of, 133–135, 156
  industries attractive to, 135
  LLC, formation of, 121
  minority owned, 155
  production industries, 135
  profile, 132
  as sector of the economy, 133
  service industries, 135
  and Shopify, 420
  size standards, 132
  and social responsibility, 47
  start-up, 133
  starting, 7
  technical innovation, 133–134
  teenagers as owners, 139
  women as owners, 138
small-business development centers (SBDCs), 153–154
small-business institutes (SBIs), 153
small-business investment companies (SBICs), 151
smartphones as public health issue, 55
smoking as public health issue, 53, 55
social acceptance, 278
social audits, 63, 64
social barriers, 85–86
social content sites, 405
social media
  advancing careers through, 5
  advantages/disadvantages, 383
  and advertising, 382
  benefits of, for business, 405
  building skills for career success, 35
  business objectives, 408–414, 429
  business use of, 403–405, 429
  defined, 29, 403
  growth potential, 425
  healthy relationship with, 41
  importance of, 403–405, 428
  marketing for consumers, 411–412
  marketing for other businesses, 412–413
  and marketing research, 320
  planning. *See* social media plan
  popularity of, 403
  for promotion, 385
  ratings, 407
  and recruitment, 254–255
  timeline, 404
  tools for business use, 405–407
  top networking sites, 408
social media communities, 408–409
social media community manager, 409
social media marketing, 411–413
social media plan
  cost of, 418
  implementation of, 416
  measuring, 416–418
  objectives, 414–415
  segmenting and targeting, 415
  steps in, 414–416, 429
  tools, 416
social media tools, 416
social needs, 279
social responsibility, 21
  best corporate citizens, 48
  commitment of executives, 62
  corporate citizenship, 48
  defined, 47
  director appointment, 62
  e-business, 425–426
  economic model of, 49
  evolution of, 48–49, 63
  as good business, 47
  government's role in, 48–49
  internet, 425–426
  introduction, 37
  planning, 62
  privacy protection, 426
  program implementation, 62, 64
  pros and cons of, 50
  public responsibilities of, 51–55
  social audit, 63
  socioeconomic model of, 49–50
  two views of, 49–50
social security, 261
socialism, 17
sociocultural forces, 315
socioeconomic model of social responsibility, 49–50
socioemotional role, 203
soft skills, 175, 253
software, 438, 439
Software-as-a-Service, 338
soldiering, 276
sole proprietorships
  advantages of, 104, 117, 125
  defined, 103
  disadvantages of, 105–106, 117, 125
  equity capital, 483
  financing, 475
  percentage of, 103
  sales receipts of, 104
  and taxes, 104
span of control, 195–196
span of management, 195–196, 206
special-event pricing, 356
specialization, 26, 27, 172–173, 189–190, 206
specialty products, 331
specialty wholesalers, 370
speculative production, 470
speed of transportation, 378
spreadsheets, 438
staff managers, 197–198
staff positions, 188
staffing. *See* human resources management (HRM)
stakeholders, 11, 410–411
standardizing, 305
standards
  of living, 26
  setting, 170, 171
standing committee, 204
start-up
  closure statistics, 143
  of corporations, 112–114
  of partnerships, 109
  of small businesses, 133
  of sole proprietorships, 104
State of Women-Owned Business Report, 138

State Trade Expansion Program (STEP), 156
statement of cash flows, 456–458, 461
statement of financial position, 449–451
statement of income and expenses, 453
statistical process control (SPC), 230
statistical quality control (SQC), 230
statistics
  defined, 442
  internet usage, 424–425
  small business closures, 143
status-quo pricing, 350
statutory monopoly, 26
stock market collapse, 34, 48
stockholders, 112, 114, 119
stockholders’ equity, 450, 452
stock-out costs, 227, 377
stocks
  defined, 112
  selling, 484–486
  types of, 114
store brands, 342
storing as marketing function, 305
storming stage of teams, 202
strategic alliance, 79–80
strategic planning process, 166
strategic plans, 167, 169
streaming services, 402
strip malls, 374
structured interviews, 256–257
subscription and pay-per-view e-business models, 424
success, 6–7
supermarkets, 372
superstores, 372–373
Supplier Diversity Program, 226
supplier partnerships, strengthening, 230
supplies, 332
supply, 23, 24
supply and demand, 23, 24
supply chain management, 367–368, 392
surveys, 385–386
survival, 350
sustainability
  and accounting, 453
  B Corp certification, 117
  defined, 30–31
  and environmentally friendly products, 148
  ethically sourced diamonds, 368
  flexitarianism, 334
  and manufacturing, 233
  packaging, 306
  and plastics, 306
  and profitability, 21, 61
  resilient manufacturing, 220
  reused/recycled products, 81
  and technological displacement, 236
SWOT analysis, 167, 168, 181, 316
syndicates, 126
synthetic process, 215

T

tables, information, 442–443
tactical plans, 168, 169
tall organization, 196
target audience, 382
target behavior, 290
target market, 310–311, 325
targeting customers, 415
tariffs, 81–82, 83
task forces, 204–205, 206
task-specialist role, 203
tax accounting, 447
taxes
  collection via AI, 437
  and corporations, 113, 118
  evasion, 437
  and limited liability companies, 119
  and not-for-profit corporations, 120
  and partnerships, 109
  and sole proprietorships, 104
taxes payable, 452
team skills, 35, 66, 95, 128, 159, 184, 208, 240, 273, 298, 328, 362, 385–386, 431–432, 464, 495
teams
  advantages of, 200, 204
  cohesiveness of, 203
  conflict resolution, 203–204
  defined, 200
  developing and using, 201–203, 206
  disadvantages of, 200
  limitations of, 204
  roles in, 203
  stages of development, 203
  types of, 200–201, 206
technical development, 340, 359
technical salespersons, 387
technical skills, 175
technological displacement, 236
technological environment, 29–30
technological forces, 315
technology
  artificial intelligence (AI). *See* artificial intelligence (AI)
  Big Tech, 211
  capital-intensive, 223
  and customer engagement, 319
  digital manufacturing, 215
  driving assistance systems, 123
  drone delivery, 376
  in fashion, 341
  future challenges, 427–428
  importance of, 29
  labor-intensive, 222
  in manufacturing, 234–236
  in production planning, 222–223
  and productivity, 232–236, 237
  robotics, 228, 234–235
  smart technology, 219
  trends in, 30
  working virtually, 201, 202
teenagers, 139
telecommuting, 202, 293–294, 296
Telephone Consumer Protection Act (1991), 54
television, 219–220, 383
television home shopping, 375–376
tell-and-listen feedback interview, 266
tell-and-sell feedback interview, 266
terminations, 267
term-loan agreements, 489
test marketing, 340, 359
Theory X, 281, 296
Theory Y, 281, 296
Theory Z, 282, 296
Theory Z (Ouchi), 282
time utility, 307
timing function of scheduling, 229
Title VII of the Civil Rights Act (1964), 268–269
tobacco use as public health issue, 53, 55
Tokyo Round, 86
top managers, 171–172
total cost, 351
total quality management (TQM), 230–231
total revenue, 351
trade agreements, 87–89
trade associations, 44
trade credit, 480–481, 483
trade deficit, 71–72
trade discounts, 357, 358
trade names, 342
trade restrictions
  pros and cons of, 83–84
  types of, 81–82
trade sales promotion method, 389
trade salespersons, 387
trade shows, 390
trade war, 82, 84
trademarks, 342, 344
trading company, 78
traditional banking services, 475–477
traditional channels, 366
traditional specialty stores, 373
training and development, 247, 248
  analysis of training needs, 263
  evaluation of, 263–264
  importance of, 262–263
  methods, 263
transactional leadership, 177, 181
transfer pricing, 357
transfers, 267
transformational leadership, 177
transparency, 273
transportation, 378–379
transporting as marketing function, 305
trough of business cycle, 22
trucks, 379
trustees, 490
Truth in Lending Act (1968), 54
turnover, 267, 271
type A, 282
type J, 282
type Z, 282

U

underrepresented groups, 155
undifferentiated approach, 311, 312
unemployment
  hard-core unemployed, 57
  training programs, 56–57
unemployment insurance, 261
unemployment rate, 14, 20, 21
Uniform Partnership Act, 107
unions, 48
unit loading, 378
United States
  absolute advantage, 70
  business in, today, 26–32
  consumer spending, 16
  COVID-19, 16
  economic outlook for trade, 73
  export assistance programs, 89
  exporting, 71
  exports and imports in 2020, 73
  in global environment, 29
  gross domestic product (GDP), 19
  international trade, 72
  manufacturing in, 212–213, 215
  post-pandemic economy, 21
  productivity rates, 232, 233, 237
  research and development (R&D), 234
  top trading partners, 74
  unemployment rate, 14
United States-Mexico-Canada Agreement (USMCA), 87, 95

Universal Product Code (UPC), 347
unlimited liability, 105, 110
unsecured bank loans, 481–482, 483
unsecured financing, 480
unsought products, 331
Uruguay Round, 86
utility, 307–308, 324

V

vaccines, 219
value, 304
value pricing, 348
vaping products, 55
variable cost, 351
Vegetarian Society, 334
vending, 376
venture capital, 151, 486
vertical mergers, 124
videos, 407
virtual careers, 202
virtual reality (VR), 30
virtual structure, 199, 206
virtual teams, 201
visual displays, 442–443

W

wage levels, 258
wage structure, 258
wage surveys, 258
wage transparency, 273
wages, individual, 258–259
warehouse clubs, 373
warehouse showrooms, 372
warehousing, 377
waste, 58, 60
Water Pollution Control Act Amendment (1972), 59
Water Quality Improvement Act (1970), 59
waterways, 379
wealth
  creation of, 15
  defined, 12
  distribution of, 12
The Wealth of Nations (Smith), 14, 189
websites for career development, 5
Western Europe, 74
Whistleblower Protection Act (1989), 46
whistle-blowing, 45–46
Whole Trade Guarantee program, 64
wholesalers, 77, 135, 305, 310, 366, 368–370, 392–393
wide span of management, 195–196
width of product mix, 336
wikis, 408
women
  and franchising, 147
  gender pay gap, 260
  in management, 172
  as percentage of workforce, 250
  SBA support for, 155
  as small-business owners, 138
Women's Business Centers (WBCs), 138
word processing, 438
work sharing, 292–293
Worker Adjustment and Retraining Notification (WARN) Act (1988), 268
workers' compensation insurance, 261
work-from-home trend, 202, 293–294
working conditions, 48
work-in-process inventory, 227
workplace diversity, 6, 56, 250–251, 270
workweek, 48
World Trade Organization (WTO), 86, 92
World Without Waste initiative, 346

Z

zero-base budgeting, 474

Online-Only Chapter

17

JESTERPOP/SHUTTERSTOCK.COM

Understanding Personal Finances and Investments

Learning Objectives

Once you complete this chapter, you will be able to:

17-1 Explain why you should manage your personal finances.

17-2 Describe how the factors of safety, risk, income, growth, and liquidity affect your investment program.

17-3 Recognize how you can reduce investment risk.

17-4 Explain the reasons people choose conservative investments.

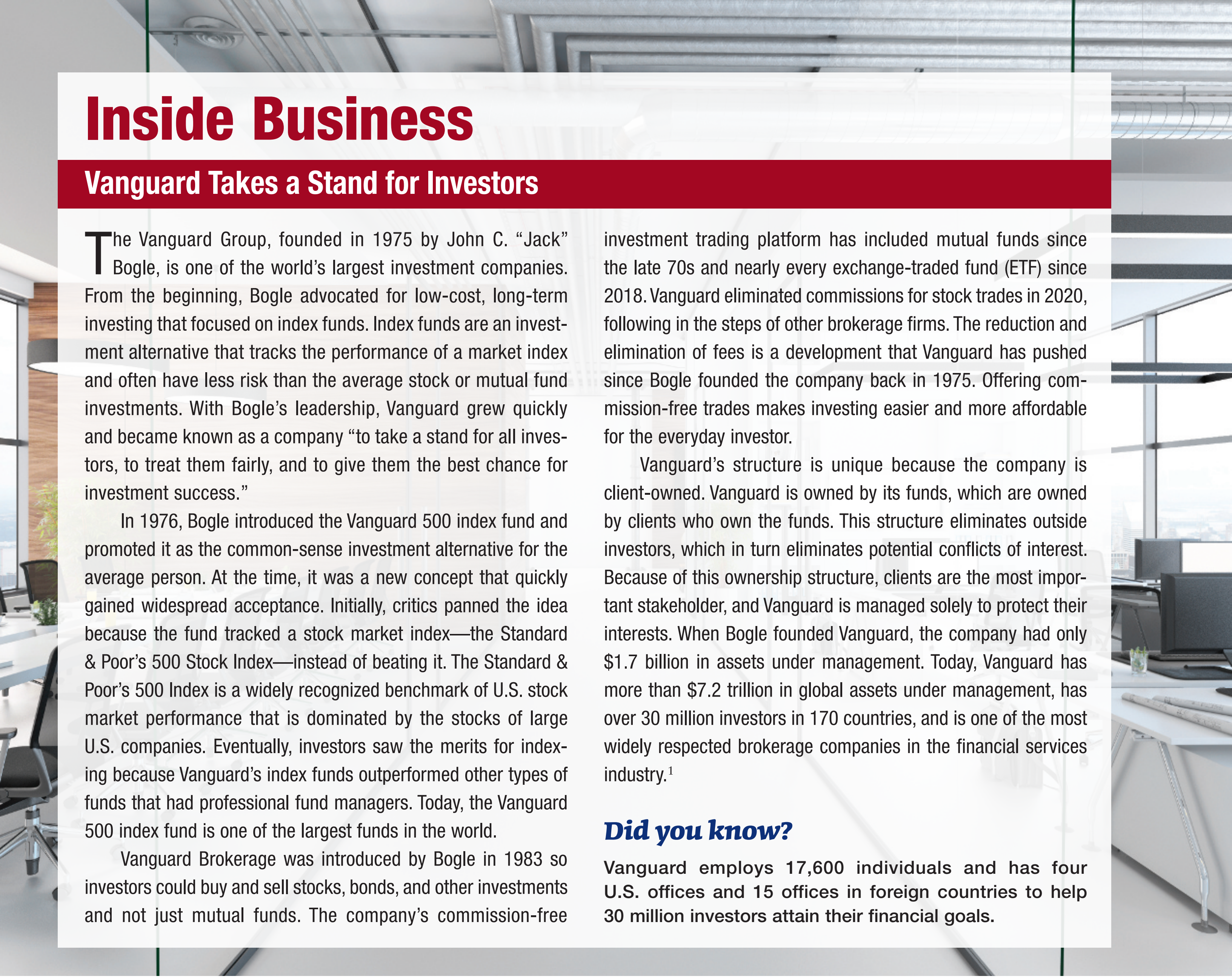
17-5 Identify the advantages and disadvantages of stocks, mutual funds, real estate, and more speculative investments.

17-6 Use financial information to evaluate investment alternatives.

17-7 Discuss how different investments are bought and sold.

Why Should You Care?

While many people dream of being rich, just dreaming doesn't make it happen. You must learn how to manage your personal finances and build a financial plan for the future.



Inside Business

Vanguard Takes a Stand for Investors

The Vanguard Group, founded in 1975 by John C. "Jack" Bogle, is one of the world's largest investment companies. From the beginning, Bogle advocated for low-cost, long-term investing that focused on index funds. Index funds are an investment alternative that tracks the performance of a market index and often have less risk than the average stock or mutual fund investments. With Bogle's leadership, Vanguard grew quickly and became known as a company "to take a stand for all investors, to treat them fairly, and to give them the best chance for investment success."

In 1976, Bogle introduced the Vanguard 500 index fund and promoted it as the common-sense investment alternative for the average person. At the time, it was a new concept that quickly gained widespread acceptance. Initially, critics panned the idea because the fund tracked a stock market index—the Standard & Poor's 500 Stock Index—instead of beating it. The Standard & Poor's 500 Index is a widely recognized benchmark of U.S. stock market performance that is dominated by the stocks of large U.S. companies. Eventually, investors saw the merits for indexing because Vanguard's index funds outperformed other types of funds that had professional fund managers. Today, the Vanguard 500 index fund is one of the largest funds in the world.

Vanguard Brokerage was introduced by Bogle in 1983 so investors could buy and sell stocks, bonds, and other investments and not just mutual funds. The company's commission-free investment trading platform has included mutual funds since the late 70s and nearly every exchange-traded fund (ETF) since 2018. Vanguard eliminated commissions for stock trades in 2020, following in the steps of other brokerage firms. The reduction and elimination of fees is a development that Vanguard has pushed since Bogle founded the company back in 1975. Offering commission-free trades makes investing easier and more affordable for the everyday investor.

Vanguard's structure is unique because the company is client-owned. Vanguard is owned by its funds, which are owned by clients who own the funds. This structure eliminates outside investors, which in turn eliminates potential conflicts of interest. Because of this ownership structure, clients are the most important stakeholder, and Vanguard is managed solely to protect their interests. When Bogle founded Vanguard, the company had only $1.7 billion in assets under management. Today, Vanguard has more than $7.2 trillion in global assets under management, has over 30 million investors in 170 countries, and is one of the most widely respected brokerage companies in the financial services industry.[1]

Did you know?

Vanguard employs 17,600 individuals and has four U.S. offices and 15 offices in foreign countries to help 30 million investors attain their financial goals.

As the saying goes, "I've been rich and I've been poor, but believe me, rich is better." Yet, just dreaming of being rich does not make it happen. Although being rich does not guarantee happiness, managing your personal finances and beginning an investment program are both worthy goals. The Vanguard Group—the company profiled in the Inside Business feature for this chapter—offers an array of investments and services to help people manage their personal finances, research investments, and buy and sell stocks, bonds, mutual funds, and other securities. Nevertheless, you must be willing to invest the time and effort required to manage your personal finances and become a good investor. Furthermore, do not underestimate how important you are when it comes to managing your money. No one is going to make you manage your money. No one is going to make you save the money you need to fund an investment program. These are your decisions—important decisions that literally can change your life.

Many people ask the question: Why begin an investment program now? To answer that question, you must understand that personal finance experts agree that the best investment program is one that stresses long-term growth over a 20- to 40-year period. As you will see later in this chapter, the dollar value of your investments may decrease over a short time period, but historically the value of quality securities has usually increased over a long time period.

A second compelling reason to start an investment program is that the sooner you start an investment program, the more time your investments have to work for you. So why do people wait to begin investing? In most cases, there are two reasons. First, they do not have the money needed to fund an investment program. However, once you begin managing your personal finances, you will be able to save the money needed to fund an investment program. The second reason people do not begin investing is because they do not know anything about investing. This chapter provides the basics you need to get started.

We begin this chapter by examining everyday money management activities and outlining the reasons for developing a personal investment plan. Next, we discuss important factors to consider when choosing investments and describe both traditional and speculative investments. Then, we explain how to use information to evaluate potential investments. Finally, we examine the methods used to buy and sell investments.

It's time! Take the first step, and begin managing your personal finances.

17-1 Managing Your Personal Finances

Although it would be nice if you could accumulate wealth magically, it is not magic. Most people begin by making sure that their "financial house" is in order. In this section, we examine several steps for effective money management that will help you prepare for an investment program.

Learning Objective

17-1 Explain why you should manage your personal finances.

17-1a Step 1: Tracking Your Income, Expenses, Assets, and Liabilities

Many personal finance experts recommend that you begin managing your money by determining your current financial condition. Often the first step is to construct a personal income statement and balance sheet. (*Note*: Both personal income statements and balance sheets were examined in more detail in Chapter 15.) A **personal income statement** lists your income and your expenses for a specific period of time—usually a month. By subtracting expenses from income, you can determine if you have a surplus or a deficit at the end of the time period. Surplus funds can be used for savings, investing, or for any purpose that you feel is important. On the other hand, if you have a deficit, you must take actions to reduce spending and pay down any debts you may have that will keep you from starting an investment program.

To get another picture of your current financial condition, you should construct a personal balance sheet. A **personal balance sheet** lists your assets and liabilities on a specific date. By subtracting your total liabilities from your total assets, you can determine your net worth. For an individual, **net worth** is the difference between the value of your total assets and your total liabilities. Over time, the goal is to increase the value of your assets (items of value that you own) and decrease liabilities (your debts).

Based on the information contained in these two statements, you can determine where you spend your money and your current financial condition. You can also take the next step: Construct a personal budget.

personal income statement a summary of your income and expenses for a specific period of time—usually a month—which shows if you have a surplus or a deficit at the end of the time period

personal balance sheet a summary of your assets and liabilities, as well as your calculated net worth, on a specific date

net worth the difference between the value of your total assets and your total liabilities

personal budget a specific plan for spending your income

17-1b Step 2: Developing a Budget that Works

A **personal budget** is a specific plan for spending your income. You begin by estimating your income for a specific period—for example, next month. For most people, their major source of income is their salary. The second step is to list expenses for the same

What does b-u-d-g-e-t spell? It spells the word budget, but some people would say it really means financial success. For many, creating a budget is one way to find out how much income they have each month that can be used to pay bills and expenses and invest. A budget is also used to determine if they have a surplus or a deficit at the end of the month.

PROSTOCK-STUDIO/SHUTTERSTOCK.COM

time period. Typical expenses include savings and investments, housing, food, medicine, transportation, entertainment, and so on. For most people, this is the area where you can make choices and increase or decrease the amount spent on different items listed in your budget. For example, you may decide to reduce the dollar amount spent on entertainment to increase the amount for savings. Above all, it is important to balance your budget so that your income is equal to the money you save, invest, or spend each month. For help managing your money and constructing a realistic budget, you may want to visit the Mint.com website (www.mint.com), the Motley Fool website (www.fool.com), or similar sites on the internet. These websites provide help and advice that can help you take the necessary steps to improve your personal finances.

After you have constructed your personal budget, you will need to compare the budgeted amounts with your actual income and expenses. The goal is that the estimated income and expenses are correct and that you have a surplus at the end of the budgeting period. If income is less than anticipated or expenses are more than budgeted, then you will need to take corrective actions to get your budget back on track. Often one change will affect other areas of your budget as well. An increase in your monthly rent payment, for instance, may mean that you have to reduce the amount spent on entertainment to balance your budget. *Caution*: Avoid the temptation to spend more than you make by using credit cards or borrowing money.

17-1c Step 3: Managing Credit Card Debt

Unfortunately, many individuals spend more than they make. They purchase items on credit and then make monthly payments and pay finance charges ranging from 10 to 21 percent or more. It makes no sense to start an investment program until payments for credit card and installment purchases are reduced or eliminated.

Although all cardholders have reasons for using their credit cards, the important point to remember is that it is *very easy* to get in trouble by using your credit cards. Watch for the following five warning signs.

1. Don’t fall behind on payments. One of the first warning signs is the inability to pay your entire balance each month.
2. Do not use your credit cards to pay for many small purchases during the month. This can often lead to a “real surprise” when you open your next credit card statement.

3. Do not use the cash advance provision that accompanies most credit cards. The reason is simple: The interest rate is usually higher for cash advances.
4. Think about the number of cards you really need. Most experts recommend that an individual have one or two cards and use these cards for emergencies only.
5. Get help if you think you are in trouble. Organizations like Money Management International (moneymanagement.org) or the National Foundation for Credit Counseling (www.nfcc.org) can often help you work out a plan to pay off credit card debt.

By reducing or eliminating credit purchases, eventually the amount of cash remaining after the bills are paid will increase and can be used to start a savings and investment program that will help you obtain your investment goals.

17-1d Investment Goals

Personal investment is the use of your personal funds to earn a financial return. Thus, in the most general sense, the goal of investing is to earn money with money. However, such a goal is completely useless for the individual because it is so vague.

In reality, an investment goal must be specific and measurable. It must also be oriented toward the future because investing is usually a long-term undertaking. By investing small amounts of money each year over a 20- to 40-year period, you can accumulate money for emergencies *and* retirement. For example, if you invest $2,000 each year and you earn 8 percent on your investments, your investment portfolio will be worth $518,113 at the end of 40 years. The above example is based on two very important factors. First, you continue to invest $2,000 each year for 40 years. Second, you choose an investment that earns an average of 8 percent each year. In reality, that means you will need to choose stocks, mutual funds, or some investment that hopefully will return 8 percent or even more. Keep in mind that an investment that earns 8 percent a year will not be guaranteed like a savings account or certificate of deposit. But remember, without risk, obtaining the larger returns that really make an investment grow is impossible. We discuss investment risk and stocks, mutual funds, and other investments later in this chapter.

Some financial planners suggest that investment goals should be stated in terms of money: "By January 1, 2028, I will have total assets of $80,000." Others believe that people are more motivated to work toward goals that are stated in terms of the particular things they desire: "By May 1, 2030, I will have accumulated enough money so that I can purchase a home." Like the goals themselves, the way they are stated depends on you. The following questions can be helpful in establishing valid investment goals:

1. What financial goals do you want to achieve?
2. How much money will you need, and when?
3. What will you use the money for?
4. Is it reasonable to assume that you can obtain the amount of money you will need to meet your investment goals?
5. What personal and economic conditions could alter your investment goals?
6. Are you willing to make the necessary sacrifices to ensure that your investment goals are met?

Keep in mind the investment goals you develop may be affected by your career choice. If you choose a career that provides above-average financial rewards, you can develop more challenging investment goals. If you choose a career that provides average or below-average financial rewards, it is still possible to develop an investment program by carefully managing your personal finances. Simply put: You must control spending and manage debt regardless of how much money you make.

personal investment the use of your personal funds to earn a financial return

Entrepreneurial Success

Five Personal Finance Habits of Successful Entrepreneurs

Around 75 to 80 percent of small businesses are self-financed, according to the U.S. Chamber of Commerce. This statistic illustrates why an entrepreneur's ability to accumulate the financial resources needed to start a business is a necessary skill—one that is often overlooked by would-be entrepreneurs. Implementing smart personal finance habits is beneficial for anyone, but it is particularly valuable for entrepreneurs who risk their time, effort, and money to start a business. The following five personal finance habits can help both individuals and would-be business owners improve their financial health.

1. Create a list of financial goals. Money goals may relate to saving a certain amount of money, investing disposable income, or paying off debt. Mark Cuban, a wealthy entrepreneur and investor on ABC's *Shark Tank*, says paying off debt is the best investment a person can make.
2. Create a plan for spending and saving. A budget can be thought of as a financial plan to forecast expenses over a period of time. A monthly budget should take into consideration income, nondiscretionary expenditures (e.g., rent, utilities, or groceries), and discretionary expenditures (e.g., streaming subscriptions, entertainment, or clothing). Spencer Barclay, CEO of Savology, an online financial planning platform, says failing to track income and expenses can undermine one's financial goals.
3. Diversify income streams. By having more than one source of income, entrepreneurs lower their personal financial risk. According to *Rich Habits: The Daily Habits of Successful People* by Tom Corley, most self-made millionaires have at least three sources of income.
4. Invest to generate passive income. Reinvesting profits back into a business is one way business owners can fuel growth. This concept also applies to personal finances. Investing disposable income instead of spending it will create passive income over time.
5. Monitor the market. Keeping track of shifts in the market will keep entrepreneurs in tune with trends that may influence buyer spending habits that could affect both their business and their finances.

While many factors such as great marketing, effective management, and great customer service contribute to the success of a business, don't underestimate the importance of managing finances. The experts agree that proper financial management can help both you and your business succeed.

Sources: Based on information in Tom Popomaronis, "5 Personal-Finance Habits of Wealthy Entrepreneurs," *Entrepreneur*, November 20, 2019, www.entrepreneur.com/article/341647; Minda Zetlin, "4 Things Mark Cuban Says You Should Do With Your Money," *Inc.*, July 25, 2020, www.inc.com/mind17-zetlin/mark-cuban-investment-advice-billionaire-shark.html; U.S. Chamber of Commerce, "Small Business Statistics," www.chamberofcommerce.org/small-business-statistics.

17-1e **A Personal Investment Program**

Once you have formulated specific goals and have some money to invest, investment planning is similar to planning for a business. It begins with the evaluation of different investment opportunities—including the potential return and risk involved in each. At the very least, this process requires some careful study and maybe some expert advice. Investors should beware of people who call themselves "financial planners" but who are in reality nothing more than salespersons for various financial investments, tax shelters, or insurance plans. A true **financial planner** has had comprehensive training in investments, insurance, taxation, retirement planning, and estate planning and has passed a rigorous examination. Most financial planners do not sell a particular investment product or receive commissions for their investment recommendations. Instead, they charge consulting fees that range from $100 to $250 an hour.

financial planner an individual who has had comprehensive training in investments, insurance, taxation, retirement planning, and estate planning and has passed a rigorous examination

Many financial planners suggest that you accumulate an "emergency fund"—a certain amount of money that can be obtained quickly in case of immediate need—before beginning an investment program. The amount of money that should be salted

Table 17-1 Suggestions to Help You Accumulate the Money Needed to Fund an Investment Program

1. *Pay your bills then pay yourself.* Many financial experts recommend that you (1) pay your monthly bills, (2) save or invest a reasonable amount of money, and (3) use whatever money is left over for personal expenses and entertainment.
2. *Take advantage of employer-sponsored retirement programs*. Many employers will match part or all of the contributions you make to a company-sponsored retirement plan.
3. *Participate in an elective savings program*. Choose to have money withheld from your paycheck each payday and automatically deposited in a savings or investment account.
4. *Make a special savings effort one or two months each year*. By cutting back to the basics, you can obtain money for investment purposes.
5. *Take advantage of gifts, inheritances, and windfalls*. During your lifetime, you likely will receive gifts, inheritances, salary increases, year-end bonuses, or federal income tax returns. Use money from these unexpected sources to fund an investment program.

Source: Jack R. Kapoor, Les R. Dlabay, Robert J. Hughes, and Melissa Hart, *Focus on Personal Finance*, 7th ed. Copyright © 2022 by The McGraw Hill Companies Inc. Reprinted with permission of The McGraw Hill Companies Inc.

away in a savings account varies from person to person. Most financial planners agree that an amount equal to at least three months' living expenses is reasonable. However, you may want to increase your emergency fund in anticipation of a crisis.

After the emergency account is established, you may invest additional funds to help achieve your investment goals. Some additional funds may already be available, or money for further investing may be saved out of earnings. For suggestions to help you obtain the money needed to fund your investment program, refer to Table 17-1.

17-1f Monitoring the Value of Your Investment Program

The stocks, bonds, mutual funds, and other investments included in your investment program can increase or decrease in value. For example, the Dow Jones Industrial Average declined almost 3,000 points—the worst one-day point decline in history—on March 16, 2020. The **Dow Jones Industrial Average** is an average of 30 leading U.S. corporations that reflect the U.S. stock market as a whole. What happened? The simple answer is that the United States (and rest of the world) experienced an economic crisis because of the COVID-19 pandemic.

The magnitude of the economic problems caused by the COVID-19 pandemic underscores the importance of being prepared for a personal financial crisis, managing your personal finances, *and* monitoring the value of your investments. Because of non-essential business closures and high unemployment rates, many people were caught off guard. Moreover, some individuals were forced to sell some or all of their investments at depressed prices just to pay for everyday necessities. Always keep in mind your circumstances and economic conditions are both subject to change.

✓ Concept Check

- How could developing a personal budget help you obtain the money needed to fund your investment program?
- What is an "emergency fund," and why is it recommended?
- What steps can you take to save the money to begin an investment program?

17-2 Important Factors in Personal Investment

How can you (or a financial planner) tell which investments are "right" for your investment program and which are not? One way to start is to match potential investments with your investment goals in terms of safety, risk, income, growth, and liquidity.

Learning Objective

17-2 Describe how the factors of safety, risk, income, growth, and liquidity affect your investment program.

Dow Jones Industrial Average an average of 30 leading U.S. corporations that reflect the U.S. stock market as a whole

17-2a Safety and Risk

Safety and risk are two sides of the same coin. *Safety* in an investment means minimal risk of loss; *risk* in an investment means a measure of uncertainty about the outcome. If you want a steady increase in value over an extended period of

RISK
SAFETY

PX MEDIA/SHUTTERSTOCK.COM

time, choose safe investments, such as certificates of deposit (CDs), highly rated government and corporate bonds, and the stocks or mutual funds that invest in the stock of highly regarded corporations—sometimes called blue-chip stocks. A **blue-chip stock** is a safe investment that generally attracts conservative investors. Typically, blue-chip stocks are issued by corporations that are industry leaders and have provided their stockholders with stable earnings and dividends over a number of years. Some real estate may also be a very safe investment.

If you want higher dollar returns on investments, you must generally give up some safety. When it comes to investing, one rule is worth remembering: *The potential return on an investment should be directly related to the risk you assume.* That is, the greater the risk you assume, the higher the potential monetary reward. As you will see later in this chapter, there are a number of speculative—and potentially profitable—investments.

Often, beginning investors are afraid of the risk associated with many investments. However, it helps to remember there is a tradeoff between safety and risk. Without risk, it is impossible to obtain larger returns that really make your investment program grow. Take a look at Figure 17-1, which illustrates the amount of money an investor would have at the end of 40 years if they chose investments that provided a 2, 4, 6, or 8 percent return. While it would be nice to get more money, the investments that provide larger returns have more risks and are not guaranteed.

In fact, some investors often base their investment decision on projections for rate of return. You can also use the same calculation to determine how much you actually earn on an investment over a specific period of time. To calculate **rate of return**, the total dollar amount of return you receive on an investment over a specific period of time is divided by the amount invested. For example, assume that you invest $5,000 in Procter & Gamble, a major manufacturer of consumer goods. You receive $130 in dividends, and the stock is worth $5,535 at the end of one year. Your rate of return is 13 percent, as illustrated on the following page.

blue-chip stock the stock of highly regarded corporations

rate of return the total dollar amount of return you receive on an investment over a specific period of time divided by the amount invested

Figure 17-1 Comparison of Potential Annual Returns with the Total Amount Accumulated at the End of 40 Years

Assume you save $300 a month during the next 40 years. Here's what you will accumulate if you choose aggressive investments or more conservative investments.

Investment Style	Average Annual Return	Total Accumulated Over 40 Years (Assumes $300 Monthly Investment)
Aggressive–mostly stocks	8 %	$932,000
Moderately aggressive–mostly stocks with some bonds	6 %	$557,000
Moderately conservative–mostly bonds with some stocks	4 %	$342,000
Conservative–mostly bonds and safer investments	2 %	$217,000

Source: Maurie Backman, "What's Your Investment Style? Take This Risk Tolerance Quiz to Find Out," The Motley Fool, https://www.fool.com (accessed April 4, 2021).

Step 1: *Subtract the investment's initial value from the investment's value at the end of the year.*

$$\$5{,}535 - \$5{,}000 = \$535$$

Step 2: *Add the dividend amount to the amount calculated in step 1.*

$$\$130 + \$535 = \$665$$

Step 3: *Divide the total dollar amount of return calculated in step 2 by the original investment.*

$$\$665 \div \$5{,}000 = 0.13 = 13 \text{ percent}$$

Note: If an investment decreases in value, the steps used to calculate the rate of return are the same, but the answer is a negative number. With this information, it is possible to compare the rate of return for different investment alternatives that offer more or less risk.

17-2b **Investment Income**

Investors sometimes purchase certain investments because they want a predictable source of income. For example, CDs, corporate and government bonds, and certain stocks pay interest or dividends each year. Some mutual funds and real estate may also offer steady income potential. Often, these investments are purchased by conservative investors who use the income to pay for necessary living expenses.

When purchasing investments for income, most investors are concerned about the issuer's ability to continue making periodic interest or dividend payments. Investors in CDs and bonds know exactly how much income they will receive each year. The dividends paid to stockholders can and do vary, even for the largest and most stable corporations. As with dividends from stock, the income from mutual funds and real estate may also vary from one year to the next.

17-2c **Investment Growth**

To investors, *growth* means that their investments will increase in value. For example, many technology companies such as Facebook, Netflix, and Amazon are considered growth companies. Growth companies like these usually pay a small cash dividend or no dividend at all. Instead, profits are reinvested in the business (as retained earnings) to finance additional expansion. In many cases, the value of the stock increases as the corporation expands.

Other investments that may offer growth potential include selected mutual funds and real estate. For example, many mutual funds are referred to as growth funds or aggressive growth funds because of the growth potential of the individual securities included in the fund.

liquidity the ability to buy or sell an investment quickly without substantially affecting the investment's value

17-2d **Investment Liquidity**

Liquidity is the ability to buy or sell an investment quickly without substantially affecting the investment's value. Investments range from cash or cash equivalents (such as investments in government securities or money-market accounts) to the other extreme of frozen investments, which you cannot convert easily into cash.

Although you may be able to sell stock, mutual-fund, and corporate-bond investments quickly, you may not regain the amount of money you originally invested because of market conditions, economic conditions, or many other reasons. It may also be difficult to find buyers for real estate. Furthermore, finding a buyer for investments in certain types of collectibles may also be difficult.

✓ Concept Check

- What is the trade-off between safety and risk?
- In general, what kinds of investments provide income? What kinds provide growth?
- How would you calculate the rate of return on a stock that you have owned for one year?

17-3 Factors That Can Improve Your Investment Decisions

Learning Objective

17-3 Recognize how you can reduce investment risk.

We begin this section with an overview of how portfolio management can reduce investment risk and factors that you should consider to choose "just the right" investments. Then in the next two sections, we describe how the investments listed in Table 17-2 can help you reach your investment goals.

17-3a Portfolio Management

"How can I choose the right investment?" That's a good question! Unfortunately, there are no easy answers because your investment goals, age, tolerance for risk, and financial resources are different from those of the next person. To help you decide what investment is right for you, consider the following:

- For the past 93 years, stocks as measured by the Standard & Poor's 500 Stock Index have returned between 11 and 12 percent.[2]

The **Standard & Poor's 500 Stock Index** is an index that contains 500 different stocks that reflect increases or decreases in value for the U.S. stock market as a whole. During the same period, U.S. government bonds and other investment alternatives have returned less than stocks. Therefore, why not just invest all your money in stocks or mutual funds that invest in stocks? After all, they offer the largest potential return. In reality, stocks may have a place in every investment portfolio, but there is more to investing than just picking a bunch of stocks or stock mutual funds.

17-3b Asset Allocation, the Time Factor, and Your Age

Asset allocation is the process of spreading your money among several different types of investments to lessen risk. Although the term *asset allocation* is a fancy way of saying it, it really means that you need to diversify your investments and avoid the pitfall of putting all of your eggs in one basket—a common mistake made by investors. Asset allocation is often expressed in percentages. For example, what percentage of your assets do you want to put in stocks and mutual funds? What percentage do you want to put in more conservative investments such as CDs and government bonds? In reality, the answers to these questions are determined by:

- The time your investments have to work for you
- Your age

Table 17-2 Investment Alternatives

While traditional investments involve less risk, they also offer lower returns than speculative or high-risk investments.

Traditional Investments	
Bank accounts	Corporate and government securities
More Speculative Investments	
Common stock	Mutual funds
Preferred stock	Real estate
The Most Speculative Investments	
Short transactions	Other speculative investments
Margin transactions	

Standard & Poor's 500 Stock Index an index that contains 500 different stocks that reflect increases or decreases in value for the U.S. stock market as a whole

asset allocation the process of spreading your money among several different types of investments to lessen risk

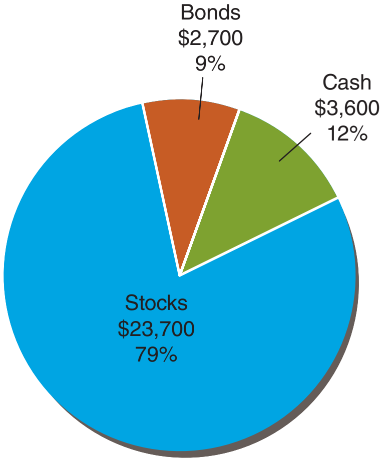
- Your investment goals
- Your ability to tolerate risk
- How much you can save and invest each year
- The dollar value of your current investments
- The economic outlook for the economy
- Several other factors

A typical asset allocation for a 32-year-old investor is illustrated in Figure 17-2. This information was obtained by entering the investor's age, current financial information, projected annual savings and other factors in the asset allocation calculator provided by Bankrate.com. Two factors—the time your investments have to work for you and your age—are so important they also deserve special attention.

The Time Factor Consider the following statistic: Since 1926, the stock market has increased in value in 70 years and lost money in 25 years.[3] If you invested during the years when the market experienced a decline *and* then needed to sell your stocks at depressed prices, you would have lost money. The amount of time you have before you need your investment money is crucial. For example, if you need your investment money in two years, you probably should invest in short-term government bonds, highly rated corporate bonds, or CDs. By taking a more conservative approach for short-term investments, you reduce the possibility of having to sell your investments at a loss because of depressed market value or a staggering economy. On the other hand, if you can leave your investments alone and let them work for five to ten years or more, then you can invest in stocks, mutual funds, and real estate.

Figure 17-2 Asset Allocation for a 32-Year-Old Investor with $30,000 to invest

Suggested investment portfolio of stocks, bonds, and cash



Source: Bankrate.com, https://www.bankrate.com/calculators/retirement/asset-allocation.aspx (accessed April 3, 2021).

Your Age You also should consider your age when developing an investment program. Younger investors tend to invest a large percentage of their nest egg in growth-oriented investments. On the other hand, older investors tend to choose more conservative investments. As a result, a smaller percentage of their nest egg is placed in growth-oriented investments. While no investor regardless of age likes to lose money on an investment, the fact is that younger investors have more time for an investment to recover its original value and even increase in value.

How much of your portfolio should be in growth-oriented investments? Many financial experts suggest that you subtract your age from 100, and the difference is the percentage of your money that should be invested in growth investments. For example, if you are 30 years old, subtract 30 from 100, which gives you 70. Therefore, 70 percent of your assets should be invested in growth-oriented investments, whereas the remaining 30 percent should be kept in safer conservative investments.

17-3c Your Role in the Investment Process

Investors want large returns, yet they are often unwilling to invest the time required to become a good investor. They would not buy a car without a test drive or purchase a home without comparing different homes, but for some unknown reason they invest without doing their homework. The suggestions given here will help you choose investments that will increase in value.

- *Evaluate potential investments.* Keep in mind that successful investors always evaluate their investments before making investment decisions. Often, it is useful to keep copies of the material you used to evaluate each investment. Then, when it is time to re-evaluate an existing investment, you will know where to begin your search for current information. Much of the information in this chapter in the section "17-6: Sources of Financial Information" will help you learn how to evaluate different investment opportunities.

Technology and Innovation

The Advantages and Disadvantages of Robo Advisors

Question: What is a robo advisor? A robo advisor is an automated digital approach to investing that uses artificial intelligence and software to choose investments and manage a clients' retirement and taxable investment accounts. Recently there has been an uptick in the number of investors using robo advisors. Schwab, Vanguard, Personal Capital, and Betterment are just four examples of brokerage firms that offer popular robo advisory services.

Robo advisors remove human emotion from investment decisions and take a numbers-driven approach using algorithms and software that considers an investor's risk tolerance and financial goals to make investment decisions. These services require little, if any, interaction with a human advisor. They often build portfolios with low-cost exchange-traded funds (ETFs) and index funds. These choices can result in lower investment expenses and increased financial returns over a long period of time. In addition to choosing investments that match an investor's profile, robo advisory services will also rebalance an investor's portfolio—either on an automatic schedule or at designated intervals—as well as provide financial planning advice and assistance.

While there are many advantages to using robo advisors, you should consider the following three factors before making a decision to use a robo advisor. First, they cannot replace a financial planner that can help you create a total, comprehensive financial plan. By eliminating the human element, investors don't receive the highest level of personalized service if they use a robo advisor. Next, while fees are lower than using traditional financial advisors, it's more expensive to use a robo advisor than making your own decisions if you are using a brokerage firm that provides zero-commission trades. Finally, there are no guarantees the investment selections made by a robo advisor will outperform the selections you make with or without the help of a financial advisor.

Robo advisory services may be ideal for individuals who are seeking an affordable, professionally managed account. However, investors should remember that all investing involves risk. Whether individuals manage their own investments or enlist the help of a financial planner or a robo advisor, it is important to build a quality investment portfolio that is customized to meet your needs, to monitor the market value of your investments, and to periodically use asset allocation to rebalance your investment portfolio.

Sources: Based on information in Arielle O'Shea, "What Is a Robo-Advisor and Is One Right for You?" *Nerd Wallet*, March 12, 2021, www.nerdwallet.com/article/investing/what-is-a-robo-advisor; Coryanne Hicks, "What Is a Robo Advisor and When to Use One," *U.S. News*, February 18, 2021, https://money.usnews.com/financial-advisors/articles/what-is-a-robo-advisor-and-when-to-use-one; Fidelity, "Robo Advisors: Affordable, Professional Investment Management," www.fidelity.com/learning-center/tools-demos/planning-guidance-tools/robo-advisor-vs-hybrid-robo-advisor.

- *Monitor the value of your investments*. Would you believe that some people invest large sums of money and do not know what their investments are worth? They do not know if their investments have increased or decreased in value. Monitoring the value of your investments will help you determine if you should continue to hold an investment, sell your investment, or buy more.
- *Keep accurate and current records*. Accurate recordkeeping can help you spot opportunities to maximize profits. In addition, accurate recordkeeping will help you determine the tax consequences of selling your investments. For tax purposes, you should keep purchase records for each of your investments that include the actual dollar cost of the investment, plus any commissions or fees you paid, along with records of dividends, interest income, or rental income you received.
- *Continue to learn about investing*. Once you begin to invest, it is important to continue to learn. Begin by choosing a specific type of investment, like stocks or mutual funds. For example, assume you are interested in stock issued by Apple. Take the time to become an "expert" about the Apple corporation. Learn as much as you can about the company, its management, its products, and its financial information. Then develop a plan to organize information about each investment you own.

Table 17-3 **Factors to Consider When Choosing Conservative or Speculative Investments**

When choosing an investment, it's a good idea to remember the rule: The potential return on an investment should be directly related to the risk you assume.

Conservative Investments with Less Risk	Speculative Investments with Higher Risks
People with little or no financial training or investment background	Investors with financial training and investment experience
Older investors with less time to retirement	Younger investors with more time to retirement
Lower-income investors	Higher-income investors
Families with young children	Married couples with no children or single individuals
Employees worried about job loss or an economic downturn	Employees with secure employment positions

The information in Table 17-3 may help you determine if conservative or speculative investments are the right choice for your investment program. Keep in mind that there are no right or wrong answers. The investment choices you make really depend on your situation, how much you know about investing, your ability to evaluate different investments, and your tolerance for risk.

✓ Concept Check

- Why should an investor be concerned about portfolio management and asset allocation?
- How do the time investments have to do their work and age affect the choice of investments for someone who is 25 years old? For someone who is 64 years old?
- What specific steps can you take to become a better investor?

17-4 Conservative Investment Alternatives

Typically, investors who are afraid of the risk associated with stocks, mutual funds, and other investment alternatives, beginning investors, investors that need a predictable source of income, or people worried about a downturn in the economy will invest their money in bank accounts, government bonds, or corporate bonds.

Learning Objective

17-4 Explain the reasons people choose conservative investments.

17-4a Bank Accounts

Bank accounts that pay interest—and therefore are investments—include passbook savings accounts, money-market accounts, CDs, and other interest-bearing accounts. These investments were discussed in Chapter 16. The interest paid on bank accounts can be withdrawn to serve as income, or it can be left on deposit and increase the value of the bank account and provide for growth. At the time of this publication, one-year CDs were paying between 0.50 and 1 percent. Although CDs and other bank accounts are risk-free for all practical purposes, many investors choose other investments because of the potential for larger returns.

17-4b Corporate Bonds and Government Securities

In Chapter 16, we discussed why corporations issue bonds to obtain financing. The U.S. government and state and local governments also issue bonds for the same reason. Investors generally choose bonds because they provide a predictable source of income.

Government Bonds Despite concerns about the increasing amount of the national debt, most investors still consider securities issued by the government to be risk-free because they are backed by the full faith and credit of the U.S. government. These securities pay lower interest than most other investments. Interest paid

Is your savings account or certificate of deposit insured? Conservative investors often ask if an investment is guaranteed. Today the Federal Deposit Insurance Corporation (FDIC) provides deposit insurance of $250,000 per depositor per bank. There is even more coverage available for different ownership categories. Similar coverage is provided by the National Credit Union Association (NCUA). To find out more about deposit coverage, go to FDIC.gov or NCUA.gov.

KATMOY/SHUTTERSTOCK.COM

on U.S. government securities is taxable for federal income tax purposes, but is exempt from state and local taxation. Generally, investors choose from the five different types of U.S. government bonds and securities described in Table 17-4. With the exception of savings bonds, the minimum purchase for each type of U.S. government security is $100 with additional increments of $100 above the minimum. For more information about U.S. government securities, go to www.treasurydirect.gov.

municipal bond sometimes called a *muni,* a debt security issued by a state or local government

Like the federal government, state and local governments sell bonds to obtain financing. A **municipal bond**, sometimes called a *muni,* is a debt security issued by

Table 17-4 Information about U.S. Government Securities

Type of Security	Maturity	Interest	Notes
Treasury bills (T-bills)	4, 8, 13, 26, or 52 weeks	T-bills are sold at a discount and the actual purchase price is less than $100.	When T-bills mature, you receive the maturity value.
Treasury notes	2, 3, 5, 7, or 10 years	Interest is paid every six months until maturity.	Interest is slightly higher than T-bills because of the longer maturity.
Treasury bonds	20 or 30 years	Interest is paid every six months until maturity.	Interest rate is slightly higher than T-bills and Treasury notes because of the longer maturity.
Treasury inflation-protected securities (TIPS)	5, 10, or 30 years; at maturity, you are paid the adjusted principal or original principal, whichever is greater.	Interest is paid every six months until maturity at a fixed rate applied to the adjusted principal.	The principal of TIPS securities increases with inflation and decreases with deflation.
Savings bonds	Pay interest for up to 30 years	Interest is added to bonds monthly and paid when you redeem savings bonds.	Minimum purchase is $25. Note: If interest is used to pay qualified college expenses, it may be exempt from federal taxation.

Source: Treasury Direct, https://treasurydirect.gov/indiv/indiv.htm (accessed March 30, 2021).

a state or local government. Municipal bonds are especially attractive to wealthy investors because interest income from municipal bonds may be tax exempt from federal taxes. Whether or not the interest on municipal bonds is tax-exempt often depends on how the funds obtained from their sale are used. *Caution: It is your responsibility, as an investor, to determine whether or not the interest paid by municipal bonds is taxable.* Because of their tax-exempt status, the interest rates on municipal bonds are lower than those on taxable bonds. By using the following formula, you can calculate the *taxable equivalent yield* for a municipal bond.

$$\text{Taxable equivalent yield} = \frac{\text{Tax-exempt yield}}{1.0 - \text{Your tax rate}}$$

For example, the taxable equivalent yield on a 2.75 percent, tax-exempt municipal bond for a person in the 37 percent tax bracket is 4.37, as shown below

$$\begin{aligned}\text{Taxable equivalent yield} &= \frac{.0275}{1.0 - .37}\\ &= 0.0437 = 4.37 \text{ percent}\end{aligned}$$

It is also your responsibility to evaluate municipal bonds. Although most municipal bonds are relatively safe, defaults have occurred in recent years.

Corporate Bonds Because they are a form of long-term debt financing that must be repaid, investment-grade corporate bonds are generally considered a more conservative investment than either stocks or mutual funds that invest in stocks. One of the principal advantages of corporate bonds is that they are primarily long-term, income-producing investments. Between the time of purchase and the maturity date, the bondholder will receive interest payments—usually semiannually, or every six months. For example, assume that you purchase a $1,000 bond—the usual face value for a corporate bond—issued by PepsiCo, the parent company of beverage company Pepsi. The interest rate for this bond is 3 percent. In this situation, you receive interest of $30 ($1,000 × 0.03 = $30) each year until the bond matures in 2027. For corporate bonds, interest is usually paid semiannually or every six months. In the case of this PepsiCo bond, a bondholder will receive two $15 interest payments each year.

Most beginning investors think that a $1,000 bond is always worth $1,000. In reality, the price of a bond may fluctuate until its maturity date. Changes in the overall interest rates in the economy are the primary cause of most bond price fluctuations. When overall interest rates in the economy increase, the market value of existing bonds with a fixed interest rate typically declines. For example, the value of the PepsiCo bond with a fixed 3 percent interest rate will decline if interest rates in the economy or interest rates for comparable bonds increase. In a situation when a bond's price declines, it may be purchased for less than its face value. By holding the bond until maturity, bond owners can redeem the bond for more than they paid for it.

A corporate bond with a fixed interest rate can also increase in value if overall interest rates in the economy decline. In this situation, a bond like the PepsiCo bond with a 3 percent fixed interest rate will increase in value if interest rates in the economy or the interest rate for comparable bonds decreases. The difference between the purchase price and the selling price for a bond is profit and is in addition to annual interest income.

Before you invest in bonds, remember that the price of a corporate bond can decrease and that interest payments and eventual repayment may be a problem for a corporation that encounters financial difficulty. The value of bonds issued by JCPenney, for instance, decreased when the retailer filed for bankruptcy. To compare potential risk and return on corporate bond issues, many investors rely on the bond ratings provided by Moody's Investors Service, Inc., Standard & Poor's Corporations, and Fitch Ratings.

Convertible Corporate Bonds A **convertible bond** is a debt security issued by a corporation that allows the owner to convert their bond to shares of the company's common stock. In many cases, corporations prefer to issue convertible bonds because they carry a 1 to 2 percent lower interest rate than nonconvertible bonds. In return for accepting a lower interest rate, owners of convertible bonds have the opportunity for increased investment growth. For example, assume that you purchase a Southwest Airlines $1,000 corporate bond that is convertible to 25.9909 shares of the company's common stock. This means that you could convert the bond to common stock whenever the price of the company's stock is $38.48 ($1,000 ÷ 25.9909 = $38.48) or higher.[4] However, owners may opt not to convert their bonds to common stock even if the market value of the common stock does increase to $38.48 or more. The reason for not exercising the conversion feature is quite simple. As the market value of the common stock increases, the price of the convertible bond also increases. By not converting to common stock, bondholders enjoy interest income from the bond in addition to the increased bond value caused by the price movement of the common stock.

✓ Concept Check

- Why do people invest in savings accounts, CDs, or government bonds when other investments offer larger returns?
- What are the advantages and disadvantages of investing in government bonds? In corporate bonds?

17-5 More Speculative Investments

Learning Objective

17-5 Identify the advantages and disadvantages of stocks, mutual funds, real estate, and more speculative investments.

Earlier in this chapter, we discussed the concepts of safety and risk. Before you examine more speculative investment alternatives, it may help to review the basic rule: *The potential return on an investment should be directly related to the risk you assume.* While all investors want larger returns, you must consider the risk involved with each of the following investments. Above all, keep in mind that dollar returns for the more speculative investments described in this section are not guaranteed.

17-5a Common Stock

convertible bond a debt security issued by a corporation that allows the owner to convert their bond to shares of the company's common stock

As mentioned in Chapter 16, corporations issue common stock to finance their business start-up costs and to help pay for ongoing business activities and expansion. Before investing in stock, keep in mind that corporations do not have to repay the money a stockholder pays for stock. So, why do people invest in stock? And, how do

Imagine financial security and sitting with a loved one in the two chairs in this photo. The dream can become a reality if you take control of your finances and learn how to invest. While there are conservative investments like savings accounts, CDs, and government and corporate bonds, the more speculative investments discussed in this section often provide larger returns that can really make your investment program grow. Be warned: these speculative investments are not guaranteed.

ALESSANDRO CANCIAN/SHUTTERSTOCK.COM

you make money by buying common stock? Basically, there are two ways: through dividend payments and through an increase in the value of the stock.

Dividend Payments One of the reasons why many stockholders invest in common stock is dividend income. As defined in Chapter 4, a *dividend* is a distribution of earnings to the stockholders of a corporation. Generally, dividends are paid on a quarterly basis. For example, American Express, a financial services and credit card company, paid its stockholders an annual dividend of $1.72 per share at the time of the publication of this text. Stockholders received a payment of $0.43 per share for each calendar quarter during the year. Dividend payments to stockholders must be approved by the company's board of directors. Although corporations are under no legal obligation to pay dividends and can reduce dividends if the company experiences financial difficulties, most corporate board members like to keep stockholders happy (and prosperous). A corporation may also pay stock dividends in place of—or in addition to—cash dividends. A **stock dividend** is a dividend in the form of additional stock. It is paid to shareholders just as cash dividends are paid—in proportion to the number of shares owned.

Increase in Dollar Value The price for a share of stock is determined by how much a buyer is willing to pay for the stock. The price may change if potential investors or current stockholders receive information about the firm or its future prospects. For example, information about future sales or projected earnings can increase or decrease the price for a share of a company's stock. In most cases, you purchase stock and then hold on to it for a period of time. If the stock's price increases or decreases, you must decide whether to sell the stock at the current price or continue to hold it. Let's assume that on March 31, 2018, you purchased 100 shares of Johnson & Johnson, a large corporation that manufactures and sells healthcare products and medical devices. At the time of your investment, you paid $130 a share. You also paid a $25 commission to purchase your Johnson & Johnson stock, for a total investment of $13,025. Let's also assume that you held your 100 shares until March 31, 2021, and then sold the Johnson & Johnson stock for $165. Your total return on investment is shown in Table 17-5. After paying commissions to buy and sell your stock, you realized a profit of $4,594 because you received dividends totaling $11.44 a share during the three-year period and because the stock's market value increased by $35 a share. Of course, if the stock's market value had decreased, or if the firm's

Table 17-5 Sample Common-Stock Transaction for Johnson & Johnson

Assumptions: **100 shares of common stock purchased on March 31, 2018, for $130 a share; 100 shares sold on March 31, 2021, for $165 a share; dividends for three years total $11.44 per share.**

Cost When Purchased		Return When Sold	
100 shares @ $130	$13,000	100 shares @ $165	$16,500
Plus commission	+25	Minus commission	−25
Total investment	**$13,025**	**Total return**	$16,475

Transaction Summary	
Total return	$ 16,475
Minus total investment	−13,025
Profit from stock sale	$ 3,450
Plus total dividends (3 years)	+ 1,144
Total return for this transaction	$ 4,594

Source: Price data and dividend amounts were taken from Yahoo Finance, http://finance.yahoo.com (accessed March 31, 2021).

stock dividend a dividend in the form of additional stock board of directors had voted to reduce or omit dividends, your return would have been less than the total dollar return illustrated in Table 17-5.

What Happens When a Company Splits Its Stock? A **stock split** is the division of each outstanding share of a corporation's stock into a greater number of shares. Often the directors of a corporation feel that there is an optimal price range within which their firm's stock is most attractive to investors. When the market value increases beyond that range, they may declare a *stock split* to bring the price down.

The most common stock splits result in one, two, or three new shares for each original share. For example, in February 2021, the board of directors of National Beverage, a Florida company known for sparkling waters and fruit juices, approved a two-for-one stock split. After this split, a stockholder who originally owned 100 shares owned 200 shares. The value of an original share was reduced to half the stock's value before the two-for-one stock split. There is no evidence to support that a corporation's long-term performance is improved by a stock split; however, some investors do profit from stock splits on a short-term basis. *Be warned: There are no guarantees that the stock will increase in value after a split.* However, the stock may be more attractive to the investing public after a stock split because of its lower share price and the belief that most corporations split their stock only when their financial future is improving and on the upswing.

17-5b **Preferred Stock**

As we noted in Chapters 4 and 16, a firm's preferred stockholders must receive their dividends before common stockholders are paid any dividends. Unlike the amount of the dividend on common stock, the dollar amount of the dividend on preferred stock is known before the stock is purchased. In addition, the owners of preferred stock have first claim, after bond owners and general creditors, on corporate assets if the firm is dissolved or enters bankruptcy. These features make preferred stock a more conservative investment with an added degree of safety and a more predictable source of income when compared with common stock.

Preferred stocks are often referred to as "middle" investments because they represent an investment midway between common stock (an ownership position for the stockholder) and corporate bonds (a lender position for the bondholder). When compared to corporate bonds, the dividend yield on preferred stocks is often higher than the yield on bonds. However, preferred stock dividends are less secure than interest payments on corporate bonds. When compared to common stocks, preferred stocks are safer investments that offer more secure dividends. They are often purchased by individuals who need a predictable source of income greater than offered by common stock investments. They are also purchased by other corporations because corporations receive a tax break on the dividend income paid by other corporations. For all other investors, preferred stocks lack the growth potential that common stocks offer and the safety of many corporate bond issues.

Keep in mind that dividends on preferred stock, as on common stock, may be omitted by action of the board of directors. While preferred stock does not represent a legal debt that must be repaid, if the firm is dissolved or declares bankruptcy, preferred stockholders do have first claim to the corporation's assets after creditors and bondholders. In reality, preferred stockholders don't receive anything if a corporation goes through bankruptcy because creditors must be paid before preferred stockholders.

stock split the division of each outstanding share of a corporation's stock into a greater number of shares

mutual fund an investment in which the money of many investors—its shareholders—is pooled for investing in a variety of different securities

17-5c **Mutual Funds and Exchange-Traded Funds**

For many investors, mutual funds are the investment of choice. More than 59 million U.S. households—approximately half of all households—own mutual funds.[5] According to the Mutual Fund Education Alliance (www.mfea.com), a **mutual fund**

Ethics and Social Responsibility

How to Put Principles Before Profit with Socially Responsible Investing

Socially responsible businesses consider how their decisions affect society and use their resources in positive ways to make a difference in the nation and the world. The most socially conscious firms put people, the planet, and ethics ahead of profits. In fact, socially responsible investing, also known as ESG (environmental, social, and governance) investing, refers to a type of investing that focuses on three factors that can affect a company's long-term impact on society.

First, socially responsible investors consider a company's impact on the environment, including the use of natural resources, use of alternative energy solutions, greenhouse gas emissions, and disposal of waste. For example, Dell has developed electronic waste (e-waste) programs to address the growing problem of how to dispose of technology waste. Although their efforts began in the mid-90s, the company continues to develop its e-waste disposal programs to combat the 53 million tons of e-waste that is generated every year.

Second, a company's social impact refers to how it treats customers, employees, suppliers, communities, and other stakeholders. Hilton Hotels, for instance, is considered one of the best companies to work for by *Fortune*. Hilton listens to employee feedback and implements programs and policies to meet their needs. Additionally, Hilton offers resources for veterans and working parents, has a generous parental leave policy, and provides extensive professional development and advancement options.

Third, socially responsible investing also considers governance issues such as accounting methods, executive compensation, board oversight of corporate culture, board diversity, and the results of ethics and social responsibility audits. Microsoft has well-established corporate governance policies and practices. For example, the company has four standing committees (audit, compensation, governance and nomination, and regulatory and public policy) made up of independent directors that assist the board with oversight responsibilities of its social responsibility initiatives.

The trend toward ESG investing is accelerating. Investors can research the ESG practices of individual companies to make their own investment decisions or invest in ESG mutual funds and exchange-traded funds (ETFs) that invest in socially responsible companies. Professional advisory services companies such as Morningstar and others have also developed ESG scoring tools to help guide investors. For ESG investors, it's easier to find information about companies that are working to improve environmental, social, and governance issues than it has ever been.

Sources: Based on information in Chris Muller, "Socially Responsible Investing: How To Become A Conscious Investor," *Money Under 30*, December 31, 2020, www.moneyunder30.com/socially-responsible-investing; Chris Villanueva, "Working Together to Eliminate E-Waste," *Dell Technologies*, October 15, 2002, www.delltechnologies.com/en-us/blog/working-together-to-eliminate-e-waste; Hilton, "Career Paths at Hilton," https://jobs.hilton.com/emea/en/career-paths; Microsoft, "Board Committees," www.microsoft.com/en-us/Investor/corporate-governance/board-of-directors.aspx; CNBC, "The Rise of ESG Investing," *YouTube*, June 25, 2020, www.youtube.com/watch?v=0Q1cliM0b0Q.

pools the money of many investors—its shareholders—to invest in a variety of different securities.[6] The major advantages of a mutual fund are its *professional management* and its *diversification*, or investment in a wide variety of securities. Most investment companies that sponsor funds do everything possible to convince you that they can do a better job of picking securities than you can. In reality, mutual funds are managed by professional fund managers who devote large amounts of time to picking just the "right" securities for their funds' portfolios. *Be warned:* Even the best portfolio managers make mistakes. So, you, the investor, must be careful and evaluate different funds before investing. Diversification spells safety because an occasional loss incurred with one security is usually offset by gains from other investments.

Mutual-Fund Basics There are basically three types of mutual funds: (1) open-end funds, (2) closed-end funds, and (3) exchange-traded funds (ETFs). The investment company sponsoring an **open-end fund** issues and sells new shares to any investor who requests them. It also buys back shares from investors who wish to sell all or

open-end fund a type of mutual fund in which the sponsoring investment company issues and sells new shares to any investor who requests them and buys back shares from investors who wish to sell them part of their holdings. A **closed-end fund** sells shares in the fund to investors only when the fund is originally organized. Once all the shares are sold, an investor must purchase shares from another investor who is willing to sell them. Shares for most closed-end funds are traded on a stock exchange or in the over-the-counter (OTC) market like stocks. The investment company is under no obligation to buy back shares from investors.

An **exchange-traded fund (ETF)** is a fund that generally invests in the stocks or securities contained in a specific stock or securities index. Although most investors think of an ETF as investing in the stocks contained in the Standard & Poor's 500 Stock Index, there are many different types of ETFs available that attempt to track all kinds of indexes including different types of stocks, bonds, and even commodities. Like closed-end funds, shares for most ETFs are traded on a stock exchange or in the OTC market.

Although exchange-traded funds are similar to closed-end funds, there is an important difference. Most closed-end funds are actively managed, with portfolio managers making the selection of stocks and other securities contained in a closed-end fund. Almost all exchange-traded funds, on the other hand, normally invest in the stocks, bonds, or securities included in a specific index. Therefore, there is less need for a portfolio manager to make investment decisions. Because of passive management, fees associated with owning shares are generally less when compared to both closed-end and open-end funds. Although increasing in popularity, there are only about 2,200 exchange-traded funds.[7]

The share value for a mutual fund is determined by calculating its net asset value. **Net asset value (NAV)** per share is equal to the current market value of the mutual fund's portfolio minus the mutual fund's liabilities divided by the number of outstanding shares. For example, the NAV for the Armstrong Pacific Rim fund is $20, as illustrated below.

$$\begin{aligned}\text{Net Asset Value} &= \frac{\text{Value of the fund's portfolio} - \text{Liabilities}}{\text{Number of shares outstanding}}\\ &= \frac{\$695\text{ million} - \$15\text{ million}}{34\text{ million shares}}\\ &= \$20\end{aligned}$$

For most mutual funds, NAV is calculated once a day and is reported in newspapers and financial publications and on the internet. Because ETFs and closed-end funds trade like stocks, their shares trade at the current market value, which can be more or less than a closed-end fund's or ETF's net asset value.

Mutual-Fund Sales Charges and Fees With regard to costs, there are two types of mutual funds: load and no-load funds. Individuals who invests in a *load fund* pay a sales charge every time they purchases shares. For some funds, this sales charge may be as high as 8.5 percent. Although many exceptions exist, the average load charge for mutual funds is between 2 and 5 percent. Instead of charging investors a fee when they purchase shares in a mutual fund, some funds charge a *contingent deferred sales fee*. Generally, this fee ranges from 1 to 5 percent of the amount withdrawn during the first five to seven years. Typically, the amount of the contingent deferred sales fee declines each year you own the fund until there is no withdrawal fee.

The purchaser of shares in a *no-load fund* pays no sales charges at all. Although some fund salespeople claim that load funds outperform no-load funds, numerous research studies, with the data cross-checked to verify the findings, indicate that no-load funds actually outperform load funds.[8] Because no-load funds offer the same type of investment opportunities as load funds, you should investigate them further before deciding which type of mutual fund is best for you.

closed-end fund a type of mutual fund in which the sponsoring investment company sells shares in the fund to investors only when the fund is originally organized

exchange-traded fund (ETF) a fund that generally invests in the stocks or other securities contained in a specific stock or securities index

net asset value (NAV) current market value of a mutual fund's portfolio minus the mutual fund's liabilities divided by the number of outstanding shares

Mutual funds also collect a yearly management fee. The average management fee is between 0.50 and 1 percent of the fund's assets. Finally, some mutual funds charge a 12b-1 fee (sometimes referred to as a *distribution fee*) to defray the costs of marketing and selling fund shares. Typically, 12b-1 fees are used to pay brokers and others who sell the fund shares. Annual 12b-1 fees are calculated on the value of a fund's assets and cannot exceed 1 percent of the fund's assets. *Note:* For a fund to be called a "no-load" fund, its 12b-1 fee must not exceed 0.25 percent of its assets. Unlike the one-time sales fees that some mutual funds charge to purchase *or* sell mutual-fund shares, the management fee and the 12b-1 fee are ongoing fees charged each year.

Together, all the different management fees; 12b-1 fees, if any; and additional operating costs for a specific fund are referred to as an **expense ratio**. As a guideline, many financial planners recommend that you choose a mutual fund with an expense ratio of 1 percent or less. To learn more about different mutual fund charges and fees, you should visit the Securities and Exchange Commission website at www.sec.gov or the Investor.gov website at www.investor.gov.

Today, mutual funds can also be classified as A, B, or C shares. With A shares, investors pay commissions when they purchase shares in the mutual fund. With B shares, investors pay commissions when money is withdrawn or shares are sold, typically during the first five to seven years. With C shares, investors often pay no commissions to buy or sell shares but usually must pay higher ongoing management and 12b-1 fees.

Managed Funds Versus Indexed Funds Most mutual funds are managed funds. In other words, there is a professional fund manager (or team of managers) who chooses the securities that are contained in the fund. The fund manager also decides when to buy and sell securities in the fund.

Instead of investing in a managed fund, some investors choose to invest in an index fund. Why? The answer to this question is simple: Over many years, index funds have outperformed managed funds. The exact statistics vary depending on the year and the specific fund, but on average the Standard & Poor's 500 Stock Index outperforms 50 to 80 percent of large-cap funds over a long period of time.[9] Simply put: It is hard to beat an index such as the Standard & Poor's 500. If the individual

expense ratio all the different management fees; 12b-1 fees, if any; and additional operating costs for a specific fund

MUTUAL
FUNDS

ONE PHOTO/SHUTTERSTOCK.COM

The investment of choice for many investors. Open-end, closed-end funds, or exchange-traded funds—take your choice. Because all three types of funds offer professional management and diversification, more than 100 million Americans own shares in funds and almost 50 percent of U.S. households own mutual fund shares. Even though they are one of the most popular investment alternatives, you still have to evaluate a fund before investing your money.

securities included in an index increase in value, the index goes up. Because an index fund contains the same securities as the index, the dollar value of a share in an index fund also increases when the index increases. Unfortunately, the reverse is also true. A second reason why investors choose index funds is the lower fees charged by these passively managed funds. The ongoing fees that mutual funds charge can make a big difference. For example, two different investors each invest $10,000. One investor chooses an index fund that has annual expenses of 0.20; the other chooses a managed fund that has annual expenses of 1.22 percent. Both funds earn 10 percent a year. After 35 years, the index fund is worth $263,683, while the managed fund is worth $190,203. That's a difference of $73,480. Thus, even though the two funds earned the same 10 percent a year, the fees and annual expenses made a substantial difference in the amount of money each investor had at the end of 35 years.

Types of Mutual-Fund Investments Based on the type of securities they invest in, mutual funds generally fall into three broad categories: stocks, bonds, and other. The majority of mutual funds are *stock funds* that invest in stocks issued by small, medium-size, and large corporations that provide investors with income, growth, or a combination of income and growth. *Bond funds* invest in corporate, government, or municipal bonds that provide investors with interest income. The third category includes funds that stress asset allocation and money-market investments or strive for a balance between stocks and bonds. Typical names for funds in one of the three categories include aggressive growth, global, sector, defensive, regional, government bonds, corporate bonds, asset allocation, lifecycle, or balanced funds. In most cases, the name of the category gives a pretty good clue to the type of investments included in the fund. For example, the John Hancock Income Fund contains stocks and other financial securities that provide income to investors that choose this fund.

To help investors obtain their investment objectives, most investment companies now allow shareholders to switch from one fund to another fund within the same family of funds. A **family of funds** exists when one investment company manages a group of mutual funds. For example, shareholders, at their option, can change from the Fidelity International Growth Fund to the Fidelity Small-Cap Discovery Fund. Generally, investors may give instructions to switch from one fund to another fund within the same family via the internet, in writing, or over the phone.

17-5d Real Estate

Real estate ownership represents one of the best hedges against inflation, but like all investments it has its risks. A piece of property in a poor location, for example, can actually decrease in value. Table 17-6 lists some of the many factors you should consider before investing in real estate.

There are, of course, disadvantages to any investment, and real estate is no exception. If you want to sell your property, you must find an interested buyer with the ability to obtain enough money to complete the transaction. Finding such a buyer can be difficult if the real estate market is in decline, financing at affordable interest rates is scarce, or you must ask too much because you overpaid for a piece of property. In situations like these, many real estate investors are forced to hold some properties longer than they want. If you are forced to hold real estate longer than you originally planned, taxes, interest, and loan payments can be a heavy burden. As a rule, real estate increases in value and eventually sells at a profit, but there are no guarantees. The degree of your success depends on how well you evaluate different alternatives.

family of funds a group of mutual funds managed by one investment company

high-risk investment an investment made in the uncertain hope of earning a relatively large profit in a short time

17-5e The Most Speculative Investment Techniques

A **high-risk investment** is one made in the uncertain hope of earning a relatively large profit in a short time. (Refer to the most speculative investments category in Table 17-2.)

Table 17-6 Real Estate Checklist

Although real estate offers one of the best hedges against inflation, not all property increases in value. Many factors should be considered before investing in real estate.

Evaluation of Property	Inspection of the Surrounding Neighborhood	Other Factors
Is the property priced competitively with similar property?	What are the present zoning requirements?	Why are the present owners selling the property?
What type of financing, if any, is available?	Is the neighborhood's population increasing or decreasing?	How long will you have to hold the property before selling it to someone else?
How much are the taxes?	What is the average income of people in the area?	How much profit can you reasonably expect to obtain?
How much will it cost to repair or remodel a property?	What is the state of repair of surrounding property? Do most of the buildings and homes need repair?	Is there a chance that the property value will decrease?

Although all investments have some risk, some investments become high-risk because of the methods used by investors to earn a quick profit. These methods can lead to large losses as well as to impressive gains. They should not be used by anyone who does not fully understand the risks involved. We begin this section with a discussion of selling short. Then we examine margin transactions and other high-risk investments.

Selling Short Normally, you buy stocks expecting that they will increase in value and then can be sold at a profit. This procedure is referred to as **buying long**. However, many securities decrease in value for various reasons. The value for a share of a corporation's stock, for example, can decrease when sales and profits are lower than expected. When this type of situation occurs, you can use a technique called selling short to make a profit when the price of a specific stock is falling. **Selling short** is the process of selling stock that an investor does not actually own but has borrowed from a brokerage firm and will repay at a later date. The idea is to sell at today's higher price and then buy later at a lower price. To make a profit from a short transaction, you must proceed as follows:

Step 1: Arrange to borrow a certain number of shares of a specific stock from a brokerage firm.
Step 2: Sell the borrowed stock immediately, assuming that the price of the stock will drop in a reasonably short time.
Step 3: After the price drops, buy the same number of shares that were sold in step 2.
Step 4: Give the newly purchased stock to the brokerage firm in return for the stock borrowed in Step 1.

Your profit is the difference between the amount received when the stock is sold in step 2 and the amount paid for the stock in step 3. For example, assume you think Best Buy is overvalued at $115 a share. You also believe the stock will *decrease* in value over the next three to four months because of the retailer's declining sales.

Step 1: You call your broker and arrange to borrow 100 shares of Best Buy stock.
Step 2: The broker then sells the borrowed stock for you at the current market price of $115 a share.
Step 3: Assume that four months later, Best Buy stock drops to $101 a share. You instruct your broker to purchase 100 shares of Best Buy stock at the current lower price.

buying long buying a stock with the expectation that it will increase in value and then can be sold at a profit

selling short the process of selling stock that an investor does not actually own but has borrowed from a brokerage firm and will repay at a later date

Step 4: The newly purchased stock is given to the brokerage firm to repay the borrowed stock.

In this example, you can make money with a short transaction—*if the stock's value does decline*. On the other hand, if the market value for a share of Best Buy increases, you lose.

Buying Stock on Margin An investor buys stock *on margin* by borrowing part of the purchase price, usually from a stock brokerage firm. The **margin requirement** is the portion of the price of a stock that cannot be borrowed. This requirement is set by the Federal Reserve Board and is currently 50 percent, which means you can borrow up to 50 percent of the cost of a stock investment. In addition to the Federal Reserve's requirement, some securities exchanges and brokerage firms may impose other restrictions on investors that use margin.

Why would investors want to buy stock on margin? Answer: Because they can buy up to twice as many shares of a company's stock when they use margin. Suppose an investor expects the price for a share of stock issued by American Electric Power Corporation—a U.S. energy company—to increase in the next three to six months. Assume you have enough cash to purchase 100 shares of the stock. However, if you buy on margin, you can purchase an additional 100 shares for a total of 200 shares. If the price of American Electric Power's stock increases by $12 per share, your profit will be $1,200 ($12 × 100 = $1,200) if you pay cash. But it will be $2,400 ($12 × 200 = $2,400) if you buy the stock using margin. By buying more shares on margin, you will earn more profit (less the interest you pay on the margin loan and customary commission charges).

Note that the stock purchased on margin serves as collateral for the borrowed funds. Before you become a margin investor, you should consider two factors. First, if the price of the stock does not increase as quickly as expected, interest costs mount and eventually drain your profit. Second, if the price of the margined stock falls, your dollar loss will be greater because you own more shares. And, if the value of a stock you bought on margin decreases to a certain point, you will receive a margin call from the brokerage firm. After the margin call, you must pledge additional cash or securities to serve as collateral for the investment. If you don't have cash or acceptable collateral, the margined stock is sold, and the proceeds are used to repay the margin loan. Any funds remaining after the loan and commissions are paid are returned to you. The exact price at which the brokerage firm issues the margin call is determined by the amount of money you borrowed when you purchased the stock. Generally, the more money you borrow, the sooner you will receive a margin call if the value of the margined stock drops.

Other High-Risk Investments We have already discussed two high-risk investments—selling short and margin transactions. Other high-risk investments include the following:

- Stock options
- Derivatives
- Commodities
- Precious metals and collectibles

Without exception, investments of this kind are normally referred to as high-risk investments for one reason or another. For example, the gold market has many unscrupulous dealers who sell worthless gold-plated lead coins to unsuspecting, uninformed investors. It pays to be careful. *Although investments in this category can lead to large dollar gains, they should not be used by anyone who does not fully understand all the potential risks involved.*

✓ Concept Check

- Describe the two methods by which investors can make money with stock investments.
- An individual may invest in stocks either directly or through a mutual fund. How are the two investment methods different?
- What are the risks and rewards of selling short and purchasing stocks on margin?

margin requirement the portion of the price of a stock that cannot be borrowed

17-6 Sources of Financial Information

Learning Objective

17-6 Use financial information to evaluate investment alternatives.

A wealth of information is available to investors. Sources include the internet, professional advisory services, brokerage firm analysts' reports, corporate reports, business periodicals, and government publications.

17-6a **The Internet**

By using the internet, investors can access a wealth of information on most investment and personal finance topics. For example, you can obtain interest rates for CDs; current price information for stocks, bonds, and mutual funds; and experts' recommendations to buy, hold, or sell an investment. You can even trade securities online.

Because the internet makes so much information available, you need to use it selectively. One of the web search engines such as Yahoo! (www.yahoo.com) or Google (www.google.com) can help you locate the information you really need. These search engines allow you to do a word search for the personal finance topic or investment alternative you want to explore. In addition to using a search engine to locate information, you can also obtain information from a number of investment sites. For example, the websites described in Table 17-7 are often used by successful investors.

Corporations, brokerage firms, investment companies that sponsor mutual funds, real estate brokers and agents, and federal and local governments also have websites where you can obtain valuable investment information. You may want to explore the information available on the internet for two reasons. First, these sites are easily accessible. All you have to do is type in the website address or use a search engine to locate the site. Second, the information on these sites may be more up-to-date than printed material obtained from published sources. Today, many of the above sources of information also use social media to connect with investors. Charles Schwab, for example, uses Facebook, Twitter, and YouTube to reach existing and potential clients.

In addition, you can access professional advisory services—a topic discussed in the next section—for information on stocks, bonds, mutual funds, and other investment alternatives.

17-6b **Professional Advisory Services**

The most detailed information about investing—especially stocks and mutual funds—is provided by professional advisory services. While some of the

Table 17-7 Six Popular Websites to Help You Establish a Successful Investment Program

Sponsor and Web Address	Description
Bloomberg (www.bloomberg.com/)	Current financial and economic news along with well-researched articles about the financial markets
CNN Business (www.cnn.com/business)	Up-to-the-minute business news and investment information that can help investors sharpen their investment skills
Kiplinger (www.kiplinger.com/)	Information on investing, money management, and wealth creation from the investor's viewpoint
Market Watch (www.marketwatch.com)	Price information about stocks and funds along with information about investing, the economy, and personal financial planning
The Motley Fool (www.fool.com)	Light-hearted financial advice and step-by-step activities to help you start an investment program
Yahoo! Finance (https://finance.yahoo.com)	Current price information and detailed financial research data for stocks, mutual funds, and bonds

Are you a bull or a bear? And how does it relate to Dow Jones? For stock investors, the bull is symbolic for a "bullish" stock market, when there are more buyers than sellers. On the other hand, when people say we're in a bear market, they believe stocks are headed down and there are more sellers than buyers. The actions of the bulls (buyers) and bears (sellers) affect the average value of 30 major corporations included in the Dow Jones Industrial Average.

H-AB PHOTOGRAPHY/SHUTTERSTOCK.COM

information may be free, registration often is required and there may be a charge for the more detailed information you may need to evaluate a potential investment. Information from these services may also be available at university and public libraries.

As discussed earlier in this chapter, Moody's, Standard & Poor's, and Fitch Ratings provide information that can be used to determine the quality and risk associated with bond issues. Value Line, Morningstar, Zacks, and Lipper also rate stock and/or mutual funds. Each advisory service provides detailed financial reports. Take a look at the information provided by Value Line for entertainment and media company Disney illustrated in Figure 17-3.

While there is a lot of detailed information about Disney in Figure 17-3, it helps to break down the entire Value Line report into different sections. For example:

- Summary information which ranks Disney for safety, timeliness, and technical strength; along with current price information, historical prices, total return, and target price projections for the company; is included toward the top of the report.
- Detailed information about revenues per share, earnings per share, dividends, total revenues, net profit, capital structure, working capital, net profit margin, and other important financial information is included in the middle and along the left side of the report.
- Information about the type of business and prospects for the future is provided toward the bottom and in the lower right-hand corner.

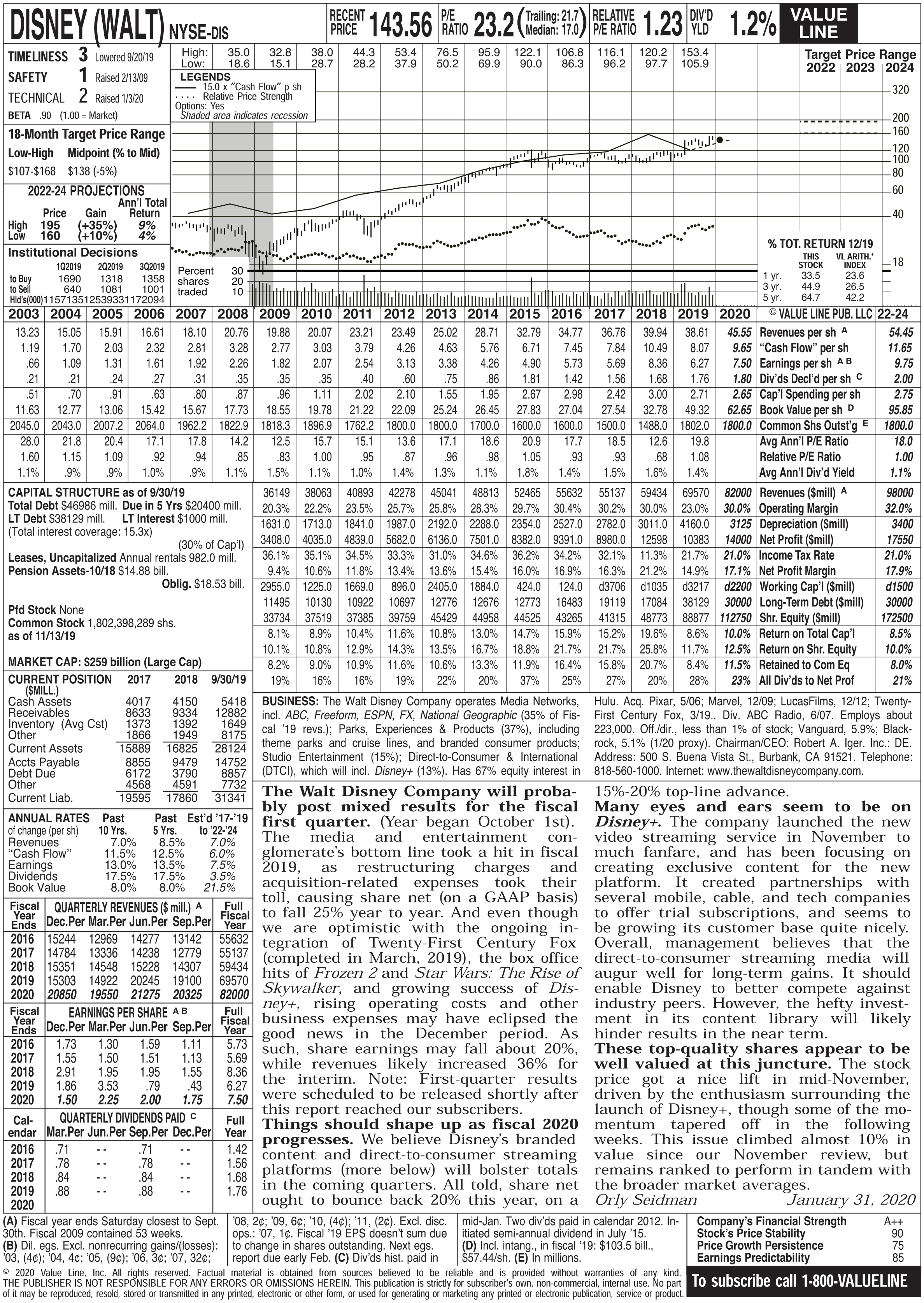
Research reports for both stocks and mutual funds published by other professional advisory services also provide detailed financial information much like the information in the Value Line report.

17-6c Additional Sources of Investment Information

Although some newspapers have eliminated or reduced their financial coverage, *The Wall Street Journal* and large metropolitan newspapers still contain some basic information about stocks, bonds, mutual funds, and other types of investments.

Figure 17-3 Value Line Research Report for Disney

A research report from Value Line is divided into parts that describe not only the financial condition of the company but also its history and outlook for the future.



LEGENDS
15.0 x "Cash Flow" p sh
Relative Price Strength
Options: Yes
Shaded area indicates recession
320
200
160
120
100
80
60
40
18
Percent shares traded
30
20
10

DISNEY (WALT) NYSE-DIS

RECENT PRICE 143.56 | P/E RATIO 23.2 (Trailing: 21.7 Median: 17.0) | RELATIVE P/E RATIO 1.23 | DIV'D YLD 1.2% | VALUE LINE

TIMELINESS 3 Lowered 9/20/19
SAFETY 1 Raised 2/13/09
TECHNICAL 2 Raised 1/3/20
BETA .90 (1.00 = Market)

High:	35.0	32.8	38.0	44.3	53.4	76.5	95.9	122.1	106.8	116.1	120.2	153.4
Low:	18.6	15.1	28.7	28.2	37.9	50.2	69.9	90.0	86.3	96.2	97.7	105.9

Target Price Range
2022 | 2023 | 2024

18-Month Target Price Range

Low-High	Midpoint (% to Mid)
$107-$168	$138 (-5%)

2022-24 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	195	(+35%)	*9%*
Low	160	(+10%)	*4%*

Institutional Decisions

	1Q2019	2Q2019	3Q2019
to Buy	1690	1318	1358
to Sell	640	1081	1001
Hld's(000)	1157135	1253933	1172094

% TOT. RETURN 12/19

	THIS STOCK	VL ARITH.* INDEX
1 yr.	33.5	23.6
3 yr.	44.9	26.5
5 yr.	64.7	42.2

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	© VALUE LINE PUB. LLC	22-24
13.23	15.05	15.91	16.61	18.10	20.76	19.88	20.07	23.21	23.49	25.02	28.71	32.79	34.77	36.76	39.94	38.61	*45.55*	Revenues per sh A	*54.45*
1.19	1.70	2.03	2.32	2.81	3.28	2.77	3.03	3.79	4.26	4.63	5.76	6.71	7.45	7.84	10.49	8.07	*9.65*	"Cash Flow" per sh	*11.65*
.66	1.09	1.31	1.61	1.92	2.26	1.82	2.07	2.54	3.13	3.38	4.26	4.90	5.73	5.69	8.36	6.27	*7.50*	Earnings per sh A B	*9.75*
.21	.21	.24	.27	.31	.35	.35	.35	.40	.60	.75	.86	1.81	1.42	1.56	1.68	1.76	*1.80*	Div'ds Decl'd per sh C	*2.00*
.51	.70	.91	.63	.80	.87	.96	1.11	2.02	2.10	1.55	1.95	2.67	2.98	2.42	3.00	2.71	*2.65*	Cap'l Spending per sh	*2.75*
11.63	12.77	13.06	15.42	15.67	17.73	18.55	19.78	21.22	22.09	25.24	26.45	27.83	27.04	27.54	32.78	49.32	*62.65*	Book Value per sh D	*95.85*
2045.0	2043.0	2007.2	2064.0	1962.2	1822.9	1818.3	1896.9	1762.2	1800.0	1800.0	1700.0	1600.0	1600.0	1500.0	1488.0	1802.0	*1800.0*	Common Shs Outst'g E	*1800.0*
28.0	21.8	20.4	17.1	17.8	14.2	12.5	15.7	15.1	13.6	17.1	18.6	20.9	17.7	18.5	12.6	19.8		Avg Ann'l P/E Ratio	*18.0*
1.60	1.15	1.09	.92	.94	.85	.83	1.00	.95	.87	.96	.98	1.05	.93	.93	.68	1.08		Relative P/E Ratio	*1.00*
1.1%	.9%	.9%	1.0%	.9%	1.1%	1.5%	1.1%	1.0%	1.4%	1.3%	1.1%	1.8%	1.4%	1.5%	1.6%	1.4%		Avg Ann'l Div'd Yield	*1.1%*

CAPITAL STRUCTURE as of 9/30/19
Total Debt $46986 mill. **Due in 5 Yrs** $20400 mill.
LT Debt $38129 mill. **LT Interest** $1000 mill.
(Total interest coverage: 15.3x)
(30% of Cap'l)
Leases, Uncapitalized Annual rentals 982.0 mill.
Pension Assets-10/18 $14.88 bill. **Oblig.** $18.53 bill.

Pfd Stock None
Common Stock 1,802,398,289 shs.
as of 11/13/19

MARKET CAP: $259 billion (Large Cap)

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020		22-24
36149	38063	40893	42278	45041	48813	52465	55632	55137	59434	69570	*82000*	Revenues ($mill) A	*98000*
20.3%	22.2%	23.5%	25.7%	25.8%	28.3%	29.7%	30.4%	30.2%	30.0%	23.0%	*30.0%*	Operating Margin	*32.0%*
1631.0	1713.0	1841.0	1987.0	2192.0	2288.0	2354.0	2527.0	2782.0	3011.0	4160.0	*3125*	Depreciation ($mill)	*3400*
3408.0	4035.0	4839.0	5682.0	6136.0	7501.0	8382.0	9391.0	8980.0	12598	10383	*14000*	Net Profit ($mill)	*17550*
36.1%	35.1%	34.5%	33.3%	31.0%	34.6%	36.2%	34.2%	32.1%	11.3%	21.7%	*21.0%*	Income Tax Rate	*21.0%*
9.4%	10.6%	11.8%	13.4%	13.6%	15.4%	16.0%	16.9%	16.3%	21.2%	14.9%	*17.1%*	Net Profit Margin	*17.9%*
2955.0	1225.0	1669.0	896.0	2405.0	1884.0	424.0	124.0	d3706	d1035	d3217	*d2200*	Working Cap'l ($mill)	*d1500*
11495	10130	10922	10697	12776	12676	12773	16483	19119	17084	38129	*30000*	Long-Term Debt ($mill)	*30000*
33734	37519	37385	39759	45429	44958	44525	43265	41315	48773	88877	*112750*	Shr. Equity ($mill)	*172500*
8.1%	8.9%	10.4%	11.6%	10.8%	13.0%	14.7%	15.9%	15.2%	19.6%	8.6%	*10.0%*	Return on Total Cap'l	*8.5%*
10.1%	10.8%	12.9%	14.3%	13.5%	16.7%	18.8%	21.7%	21.7%	25.8%	11.7%	*12.5%*	Return on Shr. Equity	*10.0%*
8.2%	9.0%	10.9%	11.6%	10.6%	13.3%	11.9%	16.4%	15.8%	20.7%	8.4%	*11.5%*	Retained to Com Eq	*8.0%*
19%	16%	16%	19%	22%	20%	37%	25%	27%	20%	28%	*23%*	All Div'ds to Net Prof	*21%*

CURRENT POSITION ($MILL.)	2017	2018	9/30/19
Cash Assets	4017	4150	5418
Receivables	8633	9334	12882
Inventory (Avg Cst)	1373	1392	1649
Other	1866	1949	8175
Current Assets	15889	16825	28124
Accts Payable	8855	9479	14752
Debt Due	6172	3790	8857
Other	4568	4591	7732
Current Liab.	19595	17860	31341

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '17-'19 to '22-'24
Revenues	7.0%	8.5%	*7.0%*
"Cash Flow"	11.5%	12.5%	*6.0%*
Earnings	13.0%	13.5%	*7.5%*
Dividends	17.5%	17.5%	*3.5%*
Book Value	8.0%	8.0%	*21.5%*

Fiscal Year Ends	QUARTERLY REVENUES ($ mill.) A Dec.Per	Mar.Per	Jun.Per	Sep.Per	Full Fiscal Year
2016	15244	12969	14277	13142	55632
2017	14784	13336	14238	12779	55137
2018	15351	14548	15228	14307	59434
2019	15303	14922	20245	19100	69570
2020	*20850*	*19550*	*21275*	*20325*	*82000*

Fiscal Year Ends	EARNINGS PER SHARE A B Dec.Per	Mar.Per	Jun.Per	Sep.Per	Full Fiscal Year
2016	1.73	1.30	1.59	1.11	5.73
2017	1.55	1.50	1.51	1.13	5.69
2018	2.91	1.95	1.95	1.55	8.36
2019	1.86	3.53	.79	.43	6.27
2020	*1.50*	*2.25*	*2.00*	*1.75*	*7.50*

Cal-endar	QUARTERLY DIVIDENDS PAID C Mar.Per	Jun.Per	Sep.Per	Dec.Per	Full Year
2016	.71	- -	.71	- -	1.42
2017	.78	- -	.78	- -	1.56
2018	.84	- -	.84	- -	1.68
2019	.88	- -	.88	- -	1.76
2020					

BUSINESS: The Walt Disney Company operates Media Networks, incl. *ABC, Freeform, ESPN, FX, National Geographic* (35% of Fiscal '19 revs.); Parks, Experiences & Products (37%), including theme parks and cruise lines, and branded consumer products; Studio Entertainment (15%); Direct-to-Consumer & International (DTCI), which will incl. *Disney+* (13%). Has 67% equity interest in Hulu. Acq. Pixar, 5/06; Marvel, 12/09; LucasFilms, 12/12; Twenty-First Century Fox, 3/19.. Div. ABC Radio, 6/07. Employs about 223,000. Off./dir., less than 1% of stock; Vanguard, 5.9%; Blackrock, 5.1% (1/20 proxy). Chairman/CEO: Robert A. Iger. Inc.: DE. Address: 500 S. Buena Vista St., Burbank, CA 91521. Telephone: 818-560-1000. Internet: www.thewaltdisneycompany.com.

The Walt Disney Company will probably post mixed results for the fiscal first quarter. (Year began October 1st). The media and entertainment conglomerate's bottom line took a hit in fiscal 2019, as restructuring charges and acquisition-related expenses took their toll, causing share net (on a GAAP basis) to fall 25% year to year. And even though we are optimistic with the ongoing integration of Twenty-First Century Fox (completed in March, 2019), the box office hits of *Frozen 2* and *Star Wars: The Rise of Skywalker*, and growing success of *Disney+*, rising operating costs and other business expenses may have eclipsed the good news in the December period. As such, share earnings may fall about 20%, while revenues likely increased 36% for the interim. Note: First-quarter results were scheduled to be released shortly after this report reached our subscribers.

Things should shape up as fiscal 2020 progresses. We believe Disney's branded content and direct-to-consumer streaming platforms (more below) will bolster totals in the coming quarters. All told, share net ought to bounce back 20% this year, on a 15%-20% top-line advance.

Many eyes and ears seem to be on *Disney+*. The company launched the new video streaming service in November to much fanfare, and has been focusing on creating exclusive content for the new platform. It created partnerships with several mobile, cable, and tech companies to offer trial subscriptions, and seems to be growing its customer base quite nicely. Overall, management believes that the direct-to-consumer streaming media will augur well for long-term gains. It should enable Disney to better compete against industry peers. However, the hefty investment in its content library will likely hinder results in the near term.

These top-quality shares appear to be well valued at this juncture. The stock price got a nice lift in mid-November, driven by the enthusiasm surrounding the launch of Disney+, though some of the momentum tapered off in the following weeks. This issue climbed almost 10% in value since our November review, but remains ranked to perform in tandem with the broader market averages.

Orly Seidman *January 31, 2020*

(A) Fiscal year ends Saturday closest to Sept. 30th. Fiscal 2009 contained 53 weeks.
(B) Dil. egs. Excl. nonrecurring gains/(losses): '03, (4¢); '04, 4¢; '05, (9¢); '06, 3¢; '07, 32¢; '08, 2¢; '09, 6¢; '10, (4¢); '11, (2¢). Excl. disc. ops.: '07, 1¢. Fiscal '19 EPS doesn't sum due to change in shares outstanding. Next egs. report due early Feb. **(C)** Div'ds hist. paid in mid-Jan. Two div'ds paid in calendar 2012. Initiated semi-annual dividend in July '15.
(D) Incl. intang., in fiscal '19: $103.5 bill., $57.44/sh. **(E)** In millions.

Company's Financial Strength	A++
Stock's Price Stability	90
Price Growth Persistence	75
Earnings Predictability	85

© 2020 Value Line, Inc. All rights reserved. Factual material is obtained from sources believed to be reliable and is provided without warranties of any kind. THE PUBLISHER IS NOT RESPONSIBLE FOR ANY ERRORS OR OMISSIONS HEREIN. This publication is strictly for subscriber's own, non-commercial, internal use. No part of it may be reproduced, resold, stored or transmitted in any printed, electronic or other form, or used for generating or marketing any printed or electronic publication, service or product.

To subscribe call 1-800-VALUELINE

Source: "Disney," The Value Line, https://research.valueline.com/api/report?documentID=2185-VL_20200131_VLIS_DIS_4129_01-7HEICJ87VLCCRVDALHS90UED1J (accessed January 21, 2020).

Coverage for most investments includes information for prices, volume of transactions, and other current information. Much of this same information (along with more detailed information) is available on the internet.

FOTOGRIN/SHUTTERSTOCK.COM

Brokerage Firm Analysts' Reports Brokerage firms employ financial analysts to prepare detailed reports on individual corporations and the securities that they believe investors should buy or sell. Such reports are based on the corporation's sales, profits or losses, management, and plans for product development and expansions. Usually, additional information on the company's industry and the current economic environment is included in brokerage reports. The reports are usually provided free to the clients.

Corporate Reports Publicly held corporations must publish annual reports, which include a description of the company, information from executives about the firm's products and plans for the future, *and* detailed financial statements that readers can use to evaluate the firm's overall performance. There should also be a letter from the accounting firm that audited the corporation. As mentioned in Chapter 15, an audit does not guarantee that a company has not "cooked" the books, but it does imply that the company has followed generally accepted accounting principles to report revenues, profits, assets, liabilities, and other financial information.

In addition, a corporation issuing a new stock issue must—by law—prepare a prospectus and ensure that copies are distributed to potential investors. A **prospectus** is a detailed, written description of a new security, the issuing corporation, and the corporation's top management. You don't have to be a stockholder to view a corporation's annual report or prospectus because they are available to the general public. To obtain an annual report, a prospectus, or other financial information go online. It's simple: Go to the corporation's website and click on "Investor Relations." You can also contact the corporation by mail or phone and request an annual report or prospectus.

Business Periodicals and Government Publications Business magazines such as *Bloomberg Businessweek*, *Fortune,* and *Forbes* provide not only general economic news but also detailed financial information about individual corporations. News magazines such as *U.S. News & World Report*, *Time*, and *Newsweek* feature financial news regularly. *Money, Kiplinger's Personal Finance Magazine, Smart Money* (digital only), and similar magazines provide information and advice designed to improve your investment skills. These periodicals are available at many libraries and by subscription. Many of these same periodicals also have a website that may contain all or selected articles that are contained in the print version.

The U.S. government is the world's largest provider of information. Much of this information is of value to investors and is either free or available at minimal cost. For example, the Securities and Exchange Commission (www.sec.gov) provides access to financial information that is reported by corporations that issue stocks and bonds. The Federal Reserve (www.federalreserve.gov) and the Bureau of Economic Analysis (www.bea.gov) also provide information that can help investors understand the financial markets and the economy.

✓ Concept Check

- How could the internet help you to research an investment?
- In addition to the internet, what other sources of financial information could help you obtain your investment goals?

prospectus a detailed, written description of a new security, the issuing corporation, and the corporation's top management

17-7 How Investments Are Bought and Sold

Learning Objective

17-7 Discuss how different investments are bought and sold.

Think back over the material that was covered in this chapter. We began by discussing why it is important to examine your current financial situation and the need to manage your money. Next, we talked about the factors that influence your choice of investments, how successful investors are involved in their investment program, and conservative and speculative investment alternatives. Then, in the last section, we discussed how you can evaluate different investment alternatives in order to make an informed decision to buy or sell an investment. Once you understand the information in the previous sections and have researched a potential investment, you can use the options described in this section to buy or sell an investment.

17-7a Purchasing Stocks and Bonds

To purchase a Geoffrey Beene sweater, you simply walk into a store that sells these sweaters, choose one, and pay for it. To purchase stocks and bonds, you work through a brokerage firm. In turn, an employee of the brokerage firm buys or sells securities for you.

Brokerage Firms and Account Executives An **account executive**—sometimes called a *stockbroker* or *registered representative*—is an individual who buys and sells securities for clients. Before choosing an account executive, you should have already determined your investment goals. Then you must be careful to communicate your goals so the account executive can do a better job of advising you. You must also decide whether you need a *full-service* broker or a *discount* broker. A full-service broker usually charges higher commissions when compared to a discount broker. Many full-service brokerage firms argue that you need a professional to help you make important investment decisions. Although this may be true for some investors, most account executives employed by full-service brokerage firms are too busy to spend unlimited time with you on a one-on-one basis, especially if you are investing a small amount. On the other side, many discount brokerage firms argue that you alone are responsible for making your investment decisions. Furthermore, they argue that discount brokerage firms have both the personnel and research materials to help you become a better investor.

The Mechanics of a Transaction Once you decide on a particular stock or bond, you can use the internet or phone your account executive to place a market or limit order. A **market order** is a request that a security be purchased or sold at the current market price. Your transaction will be completed on a security exchange like the New York Stock Exchange or the OTC market. *Note*: Both security exchanges and the OTC network were described in Chapter 16. It is also possible for a brokerage firm to match a buy order for a security for one of its customers with a sell order for the same security from another of its customers. Matched orders are not completed through a security exchange or the OTC market. Regardless of how the security is bought or sold, payment for stocks, bonds, and many other financial securities generally is required within two business days after the transaction. For example, if you buy or sell stock on Monday, the transaction will settle on Wednesday—two business days after the transaction. Today it is common practice for investors to leave stock certificates, bonds, and other securities with a brokerage firm. Because these documents are

account executive an individual, sometimes called a *stockbroker* or *registered representative,* who buys and sells securities for clients

market order a request that a security be purchased or sold at the current market price

Exploring Careers

How to Become a Certified Financial Planner

A certified financial planner (CFP) helps individuals manage their income and expenses and plan for their financial future. CFPs are certified by the Certified Financial Planner Board of Standards, Inc. Receiving formal certification is a challenging and defining moment in a financial planner's career. This certification has four requirements: formal education, successful completion of standardized exams, professional experience, and a demonstration of and commitment to ethical behavior.

First, financial planners must complete educational courses that are approved by the CFP board. Course topics include taxation, investments, risk management and insurance, and retirement and estate planning. CFP programs also include a capstone course that requires students to present a comprehensive financial plan to demonstrate their knowledge. On average, it takes 12 to 18 months to complete the coursework requirement. Additionally, candidates must hold a bachelor's degree (or higher) in any discipline from an accredited college or university.

Second, individuals must pass the CFP exam, a computer-based multiple-choice test with 170 questions that align with the concepts taught in the CFP Board's education coursework. The one-day exam is offered three times a year at professional testing facilities. Test takers face scenario-based questions as well as questions related to case studies. Passing the exam demonstrates knowledge of financial planning concepts and skills. The pass rate for first-time exam takers is around 67 percent.

Third, candidates must meet the experience requirement. Most candidates follow what is called the standard path, accruing 6,000 hours or three years in financial planning activities. The alternative is the apprenticeship path, which requires 4,000 hours or two years of experience under the direct supervision of a CFP professional.

Finally, candidates must uphold high professional and ethical standards. CFPs have a strict fiduciary duty to their clients, meaning they are required to put their clients' financial interests ahead of their own. Candidates complete an ethics declaration and agree to uphold the CFP board's code of ethics and standards of conduct. Any disclosures made by the applicant in the application process are reviewed by the board, which also conducts a background check.

Though it takes several years to complete the necessary steps to become a certified financial planner, this certification serves as recognition of a financial planner's expertise. Bottom line: CFP certification helps planners better serve their clients, upholds ethics in the financial industry, and ensures competence through ongoing educational programs.

Sources: Based on information in CFP Board, "The Certification Process," www.cfp.net/get-certified/certification-process; Julia Kagan, "Certified Financial Planner (CFP)," *Investopedia*, November 24, 2020, www.investopedia.com/terms/c/cfp.asp; Anthony Termini, "Certified Financial Planner," *Annuity.org*, February 11, 2021, www.annuity.org/financial-advisors/certifications/certified-financial-planner.

in the broker's care, transfers when the securities are sold are much easier. The phrase "left in the street name" is used to describe investor-owned securities held by a brokerage firm.

A **limit order** is a request that a security be bought or sold at a price equal to or better than (higher for selling, lower for buying) some specified price. Suppose that you place a limit order to *sell* McDonald's common stock at $225 per share. Your stock will only be sold if the stock's price is $225 per share or *higher*. If you place a limit order to *buy* McDonald's stock for $225, the stock will not be bought unless the price drops to $225 per share or *lower*. Usually, a limit order is good for one day, one week, one month, or good until canceled.

limit order a request that a security be bought or sold at a price that is equal to or better than some specified price

Commissions There is a healthy competition among brokerage firms to attract new investors. Table 17-8 shows the minimum amount to open an account, typical

PAEGAG/SHUTTERSTOCK.COM

Question: What does an account executive do? Answer: An account executive, like the one in this photo, works for a brokerage firm and helps clients buy or sell stocks, bonds, mutual funds, and other financial securities. To become an account executive, it's a good idea to have an undergraduate or master's degree in business or finance. Account executives must also pass the General Securities Representative Exam, usually referred to as the Series 7 Exam. To learn more about becoming an account executive, go to www.finra.org.

commissions charges, and other factors to consider for five popular brokerage firms. At the beginning of 2021, the minimum required to open an account for two of the five firms in the table was $0. Also, the commission for internet stock and ETF trades for all the firms was $0. The fact that the commission for internet trades was $0 for all five brokerage firms illustrates how competitive the brokerage business is. Because cost is not a factor, the features described in the fifth column can be used to choose which brokerage firm can help you obtain your investment goals. Keep in mind, some brokerage firms have strings attached to the commission-free trade offers. For example, free trades may be an introductory offer, good for a limited time, or you may have to maintain a large balance in your investment account. Finally, don't forget annual fees, research

Table 17-8 Typical Commission Charges for Stocks and Mutual Funds

Today, many brokerage firms charge no commissions for stocks and ETF trades.

	Minimum to Open an Account	Internet Stock and ETF Trades	Mutual Fund Transaction Fee*	Advantages
E*Trade	$500	$0	$19.99	Exceptional financial advice and portfolio management
Fidelity	$2,500	$0	$49.95	Great retirement planning and customer service
Interactive Brokers	$0	$0	$14.95	Excellent range of investment products and extended trading hours
Schwab	$1,000	$0	$49.95	Outstanding learning materials and comprehensive website
TD Ameritrade	$0	$0	$49.95	Strong financial research and education

*Cost to trade a mutual fund applies only to funds that are not on the brokerage firm's no-transaction-fee list.

Source: "List of the Best Brokerage Firms. Top Stock Brokers for 2021," Top Rated Firms, https://topratedfirms.com/brokers/brokerage-firm-reviews.aspx (April 4, 2021).

fees, and other fees that you may have to pay. It pays to research the details when choosing a brokerage firm.

For brokerage firms that charge commissions, a minimum commission ranging from $5 to $25 for buying *and* selling stock is common. Additional commission charges, if any, are based on the number of shares and the value of stock bought and sold.

17-7b Purchasing Mutual Funds, Real Estate, and Other Investments

The method used to buy or sell mutual funds depends on the type of fund you choose. Open-end funds, for example, can be purchased from or sold directly to the investment company that sponsors the fund on any business day. Both closed-end funds and exchange-traded funds can be purchased or sold on any business day through a securities exchange or the OTC market. The amount of sales charge also depends on the type of fund you purchase. The sales charge for load funds can be as high as 8 1/2 percent. For a load fund, you usually pay commission to buy *or* sell shares—but not to buy *and* sell shares. There is no sales charge for a no-load fund. Reminder: For fund investments, you will also pay other fees, including management fees, 12b-1 fees, if any, and operating expenses that are usually assessed each year.

Although it is possible to buy or sell real estate without using real estate agents or brokers, these professionals can help you buy or sell real estate and provide professional advice, realistic market values for different properties, and help completing the transaction. Typically, commissions are paid by the seller of the property. A broker (or account executive) is usually involved in the purchase or sale of the most speculative investment alternatives listed in Table 17-2. For example, brokers can help you purchase commodities and precious metals. It is especially important to "know" the person you are dealing with when purchasing many of the speculative investments because of the potential for fraud and misrepresentation. It pays to be careful.

Before they can start investing, most people have to decide on a career and obtain a job that will provide the money needed to finance an investment program. To help you find the right job (and the money needed to fund an investment program), read the "Careers in Business" appendix located on the text website where we provide information that can help you explore different career options.

✓ Concept Check

- Would you use a full-service or a discount brokerage firm to buy or sell stock? Explain your answer.
- What is the difference between a market order and a limit order?
- Explain the process you would use to buy real estate or a speculative investment.

Summary

17-1 Explain why you should manage your personal finances.

Although it would be nice if you could accumulate wealth magically, it is not magic. Many personal finance experts recommend that you begin the process of managing your money by determining your current financial condition. The first step often is to construct a personal income statement and a personal balance sheet. You can also construct a budget. Before you begin investing, you must manage your credit card debts. For most people, the next step is to create realistic investment goals. A personal investment program then is designed to implement these goals. Many financial planners also suggest that the investor should establish an emergency fund equivalent to at least three months' living expenses. However, you may want to increase your emergency fund in anticipation of a crisis. Then additional funds may be invested according to the investment program. Finally, all investments should be monitored carefully, and if necessary, the investment program should be modified.

17-2 Describe how the factors of safety, risk, income, growth, and liquidity affect your investment program.

Depending on their particular investment goals, investors seek varying degrees of safety, risk, income, growth, and liquidity from their investments. When investing, safety is freedom from the risk of loss. Generally, the greater the risk, the greater should be the potential return on an investment. To determine how much risk you are willing to assume, many investors calculate the rate of return. It is also possible to compare the rate of return for different investments that offer more or less risk. Income is the periodic return from an investment. Growth is an increase in the value of the investment. Liquidity is the ease with which an asset can be converted to cash.

17-3 Recognize how you can reduce investment risk.

The investments in your investment portfolio should be tailored to your goals, age, tolerance for risk, and financial resources. Asset allocation is the process of spreading your money among several different types of investments to lessen risk. Two other factors—the time your investments have to work for you and your age—should also be considered before deciding where to invest your money. To reduce investment risk and increase the returns on your investments, you should evaluate potential investments before investing your money, monitor the value of your investments on a regular basis, and keep accurate and current records.

17-4 Explain the reasons people choose conservative investments.

In this section, we examined traditional investments that include bank accounts, government bonds, and corporate bonds. Although bank accounts and bonds can provide investment growth, they are generally purchased by investors who seek a predictable source of income. There are a number of different types of bonds and securities issued by both the U.S. government (refer to Table 17-4) and local governments. There are also a number of different types of corporate bonds. Both government and corporate bonds are a form of debt financing. As a result, bonds are generally considered a more conservative investment than stocks, mutual funds that invest in stocks, or other more speculative investments.

17-5 Identify the advantages and disadvantages of stocks, mutual funds, real estate, and more speculative investments.

High-risk investment techniques can provide greater returns, but they also entail greater risk of loss. With stock investments, investors can make money through dividend payments and an increase in the value of the stock. The major advantages of mutual-fund investments are professional management and diversification. Today, there are mutual funds to meet just about any conceivable investment objective. The success of real estate investments is often tied to their location and how well each investment alternative is evaluated. You can make money by selling short when the market value of a financial security decreases. An investor can also buy stock on margin by borrowing part of the purchase price, usually from a stock brokerage firm. Other high-risk investments include stock options, derivatives, commodities, precious metals and collectibles.

17-6 Use financial information to evaluate investment alternatives.

Today, there is a wealth of information on stocks and bonds and the firms that issue them. There is also information on other types of investments, including mutual funds, real estate, and high-risk investment alternatives. Today, most investors use the internet to obtain investment information. Often, the most detailed research information about securities—and the most expensive—is obtained from professional advisory services. In addition, brokerage firm reports, corporate reports, business periodicals, and government publications can also be used to evaluate different investment alternatives.

17-7 Discuss how different investments are bought and sold.

If you invest in stocks, bonds, and other securities, chances are that you will use the services of an account executive who works for a brokerage firm. It is also possible to use a discount broker or trade securities online with a computer. Both a market order and a limit order can be used to purchase stocks on a securities exchange or in the OTC market. Today, there is a healthy competition between brokerage firms to attract new clients.

The method used to buy or sell mutual funds depends on the type of fund you choose. Open-end funds, for example, can be purchased or sold directly from the investment company that sponsors the fund on any business day. Both closed-end funds and exchange-traded funds can be purchased or sold on any business day through a securities exchange or the OTC market. While it is possible to buy or sell real estate without the help of an agent or broker, most investors rely on the professional advice provided by agents and brokers to help complete a real estate transaction. A broker or account executive is usually involved in the purchase or sale of the other speculative investment alternatives listed in Table 17-2. It is especially important to "know" the person you are dealing with when purchasing many of the speculative investments because of the potential for fraud and misrepresentation.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

personal income statement (17-3)
personal balance sheet (17-3)
net worth (17-3)
personal budget (17-3)
personal investment (17-5)
financial planner (17-6)
Dow Jones Industrial Average (17-7)
blue-chip stock (17-8)
rate of return (17-8)
liquidity (17-9)
Standard & Poor's 500 Stock Index (17-10)
asset allocation (17-10)
municipal bond (17-14)
convertible bond (17-16)
stock dividend (17-17)
stock split (17-18)
mutual fund (17-18)
open-end fund (17-19)
closed-end fund (17-20)
exchange-traded fund (ETF) (17-20)
net asset value (NAV) (17-20)
expense ratio (17-21)
family of funds (17-22)
high-risk investment (17-22)
buying long (17-23)
selling short (17-23)
margin requirement (17-24)
prospectus (17-28)
account executive (17-29)
market order (17-29)
limit order (17-30)

Discussion Questions

1. During the first six months of 2020, investors experienced dramatic declines in the value of stocks, mutual funds, and other investments. The nation and the global economy also experienced declines, and unemployment spiked, because of the COVID-19 pandemic. Then, investment values and the economy began to rebound. Based on the current state of the economy, do you think that it is a good time to begin an investment program? Justify your answer.
2. What personal circumstances might lead investors to emphasize income rather than growth in their investment planning? What might lead them to emphasize growth rather than income?
3. In this chapter, it was apparent that stocks have outperformed other investment alternatives over a long period of time. With this fact in mind, why would investors choose to use asset allocation to diversify their investments?
4. Suppose that you have just inherited 50 shares of Facebook stock. What would you do with it, if anything?
5. What kinds of information would you like to have before you invest in a specific stock, corporate bond, or mutual fund? From what sources can you get that information?

Case 17

Quicken Gets Personal with Finance Management

Quicken, the best-selling personal finance software in the United States, was first released in 1983 by Intuit, a financial software company. Before Quicken, people had to visit multiple websites to get a complete picture of their financial health. After Quicken was introduced, its user-friendly software allowed individuals to see all of their financial information in one place. To make Quicken even better, its software allows users to capture account information from different financial institutions and online billers and import it to their Quicken account in a few easy steps.

Once information is posted to users' accounts, they get a total picture for how they spend their income. Detailed information about banking, monthly loan payments, credit cards, and other payments, for example, is automatically placed in different categories using a template to record home expenses, taxes, utilities, food and dining, and entertainment. Categories can also be customized by individual users to meet their special needs.

Reporting tools can also be customized to provide users with a variety of reports that give users an even deeper look at their checking, savings, and investing accounts, net worth, total spending, taxes, rental property, income and expenses for a business, and more. All reports are designed to help users understand their cash flow, identify places to save money, make informed spending decisions, prepare for filing taxes, and see trends in spending.

Quicken also has features to help users plan for the future. There are tools to help individuals create budgets, monitor debt reduction, track saving goals, and more. The budget feature, for example, allows users to see their current spending for different budgeted categories, showing how much is left or when a budget category has been maxed out. The Quicken Mobile App provides a way for users to even manage their finances on the go when they are away from home. And, Quicken can also help users with tracking the value of their investments and measuring progress toward attaining their investment goals.

Quicken was originally owned by Intuit—the software company known for QuickBooks and TurboTax. Eventually, Intuit sold Quicken to private equity firm H.I.G. Capital, with the condition that Quicken's general manager Eric Dunn continue to operate the firm for the new owners. Eventually, Quicken became a completely independent company, led by Dunn and additional members from the early Quicken team. Although it is still the best-selling financial management software in the United States, the competitive landscape has become more complex as free-to-use budget apps and cloud-based software solutions have entered the market. Today, competitors include Personal Capital, Moneyspire, Mint, MoneyPatrol, PocketSmith, Betterment, and many more.

Since Quicken's initial release, more than 17 million people have used its software. Today, it has an active user base of 2.5 million people. To make sure it remains number one, Quicken has a renewed focus on product development, product quality, and customer care. Quicken's robust and comprehensive capabilities, long history, and brand recognition are major strengths that will help it expand its market share and help even more people manage their finances. According to Eric Dunn, who is now Quicken's CEO, "This is a durable software company that can last forever."[10]

Questions

1. Assume you are employed and your take-home pay is $3,500 a month. Your expenses total $3,100 a month, but you never seem to have any money left over for savings and investing. Do you think a personal finance software product like Quicken could help you manage your finances?
2. Based on what you read in this case, what type of information could help you improve your personal finance management skills?
3. Although Quicken is the best-selling personal finance software in the United States, it now has competitors that offer their own software and tools to help people manage their finances. What information would you need to determine which company could help you manage your finances? Be sure and list the questions you would ask to determine your choice and where you could get answers.

Building Skills for Career Success

1. Social Media Exercise

A growing number of people are turning to social media to share information and questions about investing. For example, Reddit is a news "aggregator" and discussion forum that allows people to ask questions and share opinions about thousands of topics. There are even "subreddits" for personal finance and investing. Recently, some investors use the subreddit site r/wallstreetbets to encourage investors to buy stock issued by GameStop. The result: GameStop's stock price that had been as low as $18 a share at the beginning of 2021 increased to a high of $483 a share. Because of the unusual price movement, some investors made huge profits, brokerage firms changed the rules for investing in the stock, and the United States Congress held hearings to investigate if there was a need to increase regulation of the financial markets.

Assignment

1. Do you think peer-to-peer personal finance and investment social media websites are valuable? Why or why not?
2. How would you judge the information that is obtained from peer-to-peer collaboration when it comes to investing your money or managing your personal finances?
3. Should investors that use social media to "pump up" a stock's price be allowed to profit when the share price increases?

2. Building Team Skills

According to many financial experts, the logical place to begin the search for quality investments is to examine the products and services you use on a regular basis. This suggestion is based on the assumption that if you like the product or service and you feel that you got excellent value for your money, other consumers will too. And while it may be obvious, a satisfied, growing customer base can mean increased sales, profits, and ultimately higher stock values for the company that manufactured the product or provided the service.

Assignment

1. Form teams of three or four people. Begin by discussing different products or services that team members have purchased in the last 30 days. Then choose one product or service that the team believes was worth the money.

2. For the product or service chosen, describe the attributes or features that led to this choice.
3. Determine if the company that made the product or provided the service is a public company that has issued stock.*
4. Use the internet to research the investment potential for this company. Be sure to look at the firm's financial statements, its management team, competition in the marketplace, and other information about the company and its future prospects.
5. With all team members participating, prepare a report to summarize how the team researched this investment and why the team feels this company would be a good or bad investment at this time.

3. Researching Different Careers

Today many people choose a personal financial advisor to help develop an investment program that will help them achieve their financial goals. Not only is this career choice an opportunity to help others, but it is also a career choice that offers above average salaries. And, the number of job opportunities for financial advisors is expected to increase between now and the year 2029. For help completing this exercise, use the *Occupational Outlook Handbook* in your college's library or career center or go to www.bls.gov/ooh/business-and-financial/personal-financial-advisors.htm.

Assignment

1. Answer the following questions based on information obtained in the *Occupational Outlook Handbook*.
    a. What is the nature of the work performed by financial advisors?
    b. What type of training or qualifications is required for a career in financial planning?
    c. Where are the job opportunities for personal financial advisors?
    d. What are typical annual wages for a personal financial advisor?
2. Summarize your findings in a report. Be sure to include if you would choose this career and why.

---

*If the company that manufactured the product or service you chose is not a public company, choose another product or service.

Endnotes

1 Based on information in CNBC, "Vanguard Founder Jack Bogle's '90s Interview Shows His Investing Philosophy," *YouTube*, January 17, 2019, www.youtube.com/watch?v=teqK4Y5M4yc; Vanguard, "Vanguard Continues to Lower the Cost of Investing with Expansion of Commission-Free Platform Beyond ETFs," January 2, 2020, https://pressroom.vanguard.com/news/Press-Release-Vanguard-Expands-Commission-Free-Platform-Beyond-ETFs.html; Vanguard, "Fast Facts about Vanguard," https://about.vanguard.com/who-we-are/fast-facts; Vanguard, "John C. Bogle: A Look Back at the Life of Vanguard's Founder," *YouTube*, September 19, 2019, www.youtube.com/watch?v=sFcUBLYR1g0.

2 The S&P 500 Historical Annual Returns [1970-2020], FINASKO, https://finasko.com/sp-500-returns/ (accessed December 9, 2020).

3 "Vanguard Portfolio Allocation Models," Vanguard Group, https://personal.vanguard.com/us/insights/saving-investing/model-portfolio-allocation (accessed April 5, 2021).

4 Ambrogio Visconti, "Southwest Airlines Co.'s 1.250% Convertible Notes," *Global Legal Chronicle*, http://www.globallegalchronicle.com/southwest-airlines-co-s-1-250-convertible-notes, May 1, 2020.

5 The Investment Company Institute, www.ici.org (accessed March 31, 2021).

6 The Mutual Fund Education Alliance, www.mfea.com (accessed March 30, 2021).

7 The Investment Company Institute, www.ici.org (accessed March 31, 2021).

8 Daniel Cross, "Breaking Down Load Versus No-Load Mutual Funds," MutualFund.com, https://mutualfunds.com/no-load-funds/breaking-down-load-versus-no-load-mutual-funds/ (accessed January 22, 2021).

9 "Spiva Statistics & Reports—United States Percentage of Large-Cap Funds that Underperformed the S&P 500 Index," *Spiva Statistics & Reports*, https://us.spindices.com/spiva/#/reports (accessed January 25, 2021).

10 Based on information in Sam Smith, "The Ups & Downs Of Quicken And How It Survived The Market," *Medium*, March 10, 2021, https://wefindthebiz.medium.com/the-ups-downs-of-quicken-and-how-it-survived-the-market-e023d8a1e2b3; Quicken, "Our Story," www.quicken.com/about-us; Craig Tsuchiya, "How to Get the Most Out of Quicken Reports," *Quicken*, July 29, 2020, www.quicken.com/blog/quicken-reports-best-of-2020; Quicken, "Quicken for Windows - Getting to Know Quicken for Windows," *YouTube*, May 28, 2019, www.youtube.com/watch?v=CyzqoiAw4kc; Gregg Keizer, "Quicken Aims to Restore Glory Days," *Computerworld*, April 6, 2016, www.computerworld.com/article/3052640/quicken-aims-to-restore-glory-days.html; Quicken, "Quicken Completes Acquisition by H.I.G. Capital and Outlines Vision," April 5, 2016, www.quicken.com/about-us/press/quicken-completes-acquisition-hig-capital-and-outlines-vision; Gregg Keizer, "Intuit Sells Quicken to Private Equity Firm in Management Buyout," *Computerworld*, March 4, 2016, www.computerworld.com/article/3041032/intuit-sells-quicken-to-private-equity-firm-in-management-buyout.html.

Online-Only Chapter 18

METAMORWORKS/SHUTTERSTOCK.COM

Enhancing Union-Management Relations

Learning Objectives

Once you complete this chapter, you will be able to:

18-1 Explain how and why labor unions came into being.

18-2 Discuss trends in union membership.

18-3 Identify the main focus of several major pieces of labor-management legislation.

18-4 Explain the process involved in forming a union.

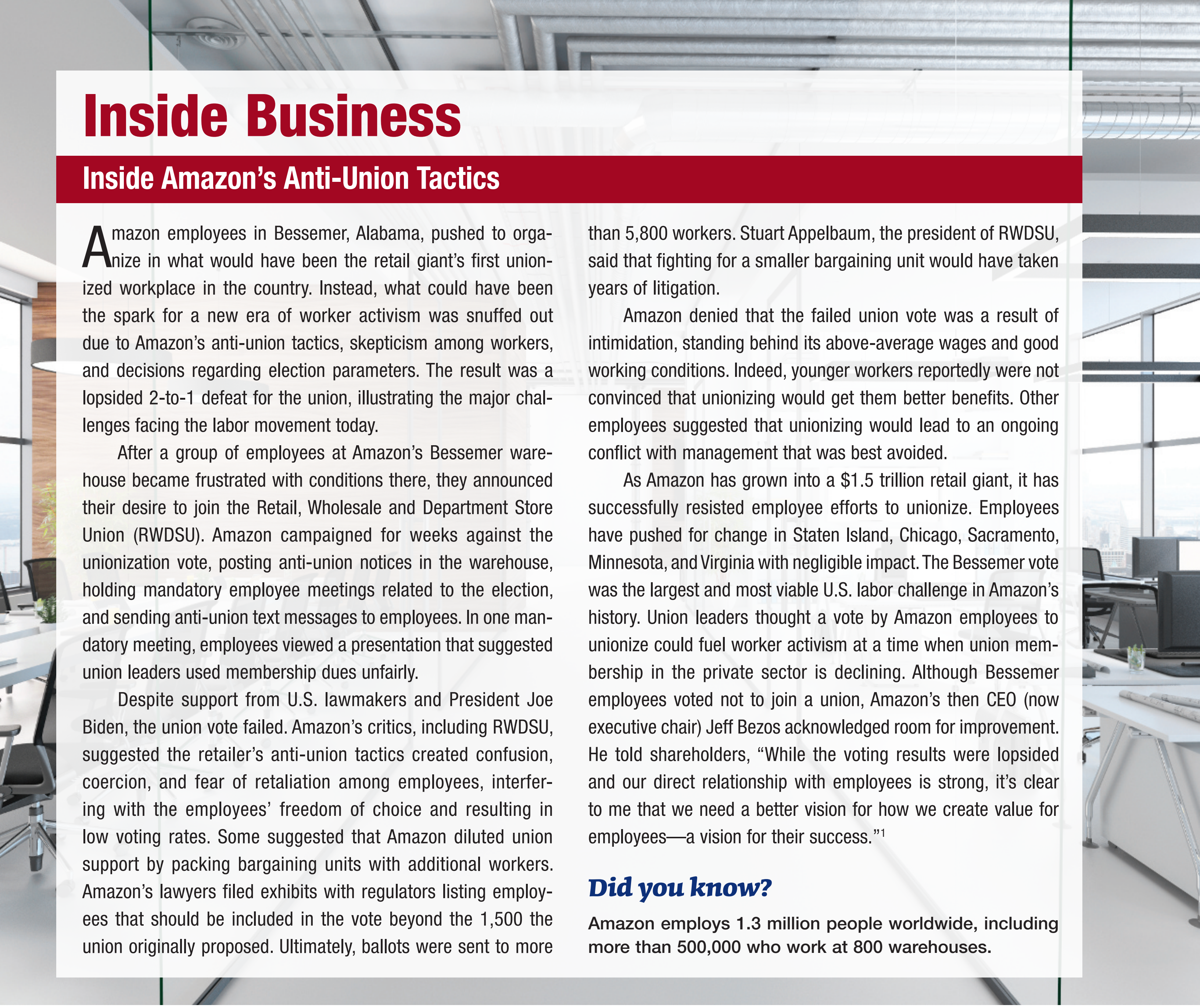
18-5 Describe the basic elements of the collective-bargaining process.

18-6 Identify the major issues covered in a union-management contract.

18-7 Explain the primary bargaining tools available to unions and management.

Why Should You Care?

Although union membership has declined overall in the United States, it remains a significant force in some industries. Additionally, unions are now looking to new industries, such as high technology and medicine, to grow their membership. Understanding union-management relations can therefore be an important element of business management.



Inside Business

Inside Amazon's Anti-Union Tactics

Amazon employees in Bessemer, Alabama, pushed to organize in what would have been the retail giant's first unionized workplace in the country. Instead, what could have been the spark for a new era of worker activism was snuffed out due to Amazon's anti-union tactics, skepticism among workers, and decisions regarding election parameters. The result was a lopsided 2-to-1 defeat for the union, illustrating the major challenges facing the labor movement today.

After a group of employees at Amazon's Bessemer warehouse became frustrated with conditions there, they announced their desire to join the Retail, Wholesale and Department Store Union (RWDSU). Amazon campaigned for weeks against the unionization vote, posting anti-union notices in the warehouse, holding mandatory employee meetings related to the election, and sending anti-union text messages to employees. In one mandatory meeting, employees viewed a presentation that suggested union leaders used membership dues unfairly.

Despite support from U.S. lawmakers and President Joe Biden, the union vote failed. Amazon's critics, including RWDSU, suggested the retailer's anti-union tactics created confusion, coercion, and fear of retaliation among employees, interfering with the employees' freedom of choice and resulting in low voting rates. Some suggested that Amazon diluted union support by packing bargaining units with additional workers. Amazon's lawyers filed exhibits with regulators listing employees that should be included in the vote beyond the 1,500 the union originally proposed. Ultimately, ballots were sent to more than 5,800 workers. Stuart Appelbaum, the president of RWDSU, said that fighting for a smaller bargaining unit would have taken years of litigation.

Amazon denied that the failed union vote was a result of intimidation, standing behind its above-average wages and good working conditions. Indeed, younger workers reportedly were not convinced that unionizing would get them better benefits. Other employees suggested that unionizing would lead to an ongoing conflict with management that was best avoided.

As Amazon has grown into a $1.5 trillion retail giant, it has successfully resisted employee efforts to unionize. Employees have pushed for change in Staten Island, Chicago, Sacramento, Minnesota, and Virginia with negligible impact. The Bessemer vote was the largest and most viable U.S. labor challenge in Amazon's history. Union leaders thought a vote by Amazon employees to unionize could fuel worker activism at a time when union membership in the private sector is declining. Although Bessemer employees voted not to join a union, Amazon's then CEO (now executive chair) Jeff Bezos acknowledged room for improvement. He told shareholders, "While the voting results were lopsided and our direct relationship with employees is strong, it's clear to me that we need a better vision for how we create value for employees—a vision for their success."[1]

Did you know?

Amazon employs 1.3 million people worldwide, including more than 500,000 who work at 800 warehouses.

Despite Amazon's wariness toward unions, many businesses today have highly cooperative relationships with labor unions in industries where they are common. A **labor union** is an organization of workers acting together to negotiate their wages and working conditions with employers. In the United States, nonmanagement employees have the legal right to form unions and to bargain, as a group, with management. The result of the union bargaining process is a *labor contract,* a written agreement that is in force for a set period of time (usually one to three years). The dealings between labor unions and business management, both in the bargaining process and beyond it, are called **union-management relations** (or **labor relations**).

labor union an organization of workers acting together to negotiate their wages and working conditions with employers

union-management relations (or labor relations) the dealings between labor unions and business management both in the bargaining process and beyond it

We open this chapter by reviewing the history of labor unions in this country. Then we turn our attention to organized labor today, noting current membership trends and union-management partnerships and summarizing important labor-relations laws. We discuss the unionization process, why employees join unions, how a union is formed, and what the National Labor Relations Board (NLRB) does. Then, collective-bargaining procedures are explained. Next, we consider issues in union-management contracts, including employee pay, working hours, security, management rights, and grievance procedures. We close with a discussion of various labor and management negotiating techniques: strikes, slowdowns and boycotts, lockouts, mediation, and arbitration.

18-1 The Historical Development of Unions

Learning Objective

18-1 Explain how and why labor unions came into being.

Until the middle of the 19th century, there was very little organization of labor in the United States. Groups of workers occasionally did form a **craft union**, an organization of skilled workers in a single craft or trade. These alliances were usually limited to a single city, and they often lasted only a short time. In 1786, the first-known strike in the United States involved a group of Philadelphia printers who stopped working over demands for higher wages. The group disbanded when the employers granted the printers a pay increase.

18-1a Early History

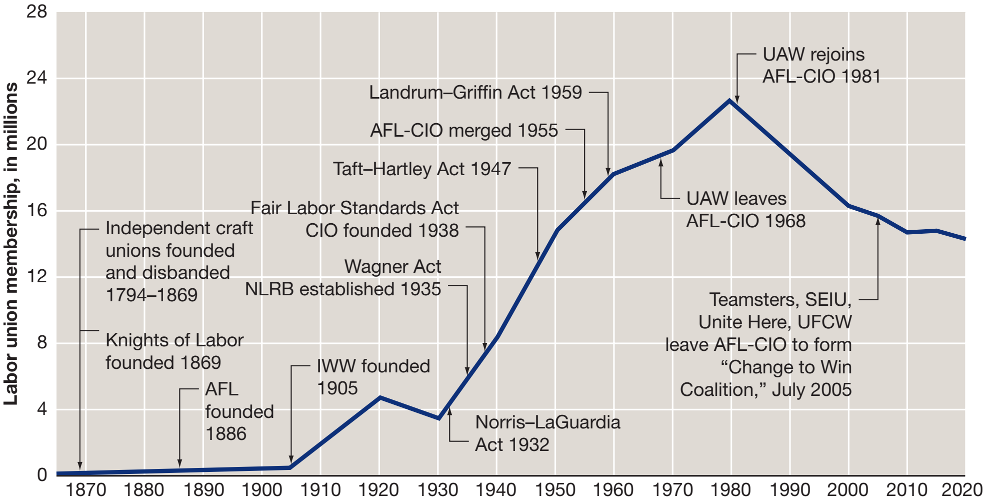
In the mid-1800s, improved transportation opened new markets for manufactured goods. Improved manufacturing methods made it possible to supply those markets, and American industry began to grow. The Civil War and the continued growth of the railroads after the war led to further industrial expansion. Large-scale production required more and more skilled industrial workers. As the skilled labor force grew, craft unions emerged in the more industrialized areas. From these craft unions, three significant labor organizations evolved. (Refer to Figure 18-1 for a historical overview of unions and their patterns of membership.)

craft union an organization of skilled workers in a single craft or trade

BETTMANN/GETTY IMAGES

Life before unions. Working conditions 100 years ago were often crowded, unpleasant, unsafe, and in some cases, lethal. In many less-developed nations, they still are.

Figure 18-1 **Historical Overview of Unions**



Source: Annual union membership data from multiple years, U.S. Department of Labor, Bureau of Labor Statistics, https://www.bls.gov/bls/news-release/#UNION2 (accessed March 25, 2021).

Knights of Labor The first significant national labor organization to emerge was the *Knights of Labor*, which was formed as a secret society in 1869 by Uriah Stephens, a Utopian reformer and abolitionist from Philadelphia. Membership reached approximately 700,000 by 1886. One major goal of the Knights was to eliminate the depersonalization of the worker, which resulted from mass-production technology. Another was to improve the moral standards of both employees and society. To the detriment of the group, its leaders concentrated so intently on social and economic change that they did not recognize the effects of technological change. Moreover, they assumed that all employees had the same goals as the Knights' leaders: social and moral reform.

The major reason for the demise of the Knights was the Haymarket Riot of 1886. At a rally in Chicago's Haymarket Square, called to demand a reduction in the length of a workday from ten to eight hours, a bomb exploded. Several police officers and civilians were killed or wounded. The Knights were not implicated directly, but they quickly lost public favor.

American Federation of Labor In 1886, several leaders of the Knights of Labor joined with independent craft unions to form the *American Federation of Labor* (AFL). Samuel Gompers, one of the AFL's founders, became its first president. Gompers believed that the goals of the union should be those of its members rather than those of its leaders. The AFL did not seek to change the existing business system, as the Knights of Labor had. Instead, its goal was to improve its members' living standards within the system.

Another major difference between the Knights of Labor and the AFL was in their positions regarding strikes. A **strike** is a temporary work stoppage by employees, calculated to add force to their demands. The Knights did not favor the use of strikes, whereas the AFL strongly believed that striking was an effective labor weapon. The AFL also believed that organized labor should play a major role in politics. As we will see, the AFL is still very much a part of the American labor scene.

Industrial Workers of the World The *Industrial Workers of the World* (IWW) was created in 1905, as a radical alternative to the AFL. Among its goals was the overthrow of capitalism. This revolutionary stance prevented the IWW from gaining much of a foothold. Perhaps its major accomplishment was to make the AFL seem, by comparison, less threatening to the general public and to business leaders.

strike a temporary work stoppage by employees, calculated to add force to their demands

18-1b **Evolution of Contemporary Labor Organizations**

Between 1900 and 1920, both business and government attempted to keep labor unions from growing. This period was plagued by strikes and violent confrontations between management and unions. In steelworks, garment factories, and auto plants, clashes took place in which striking union members fought bitterly against nonunion workers, police, and private security guards.

The AFL continued to be the major force in organized labor. By 1920, its membership included 75 percent of all those who had joined unions. Throughout its existence, however, the leadership of the AFL had been undecided as to the best way to deal with unskilled and semiskilled workers. Most of its members were workers skilled in specific crafts or trades. However, technological changes during World War I had brought about a significant increase in the number of unskilled and semiskilled employees in the workforce. These people sought to join the AFL, but they were not well received by its established membership.

Some unions within the AFL did recognize the need to organize unskilled and semiskilled workers, and they began to penetrate the auto and steel industries. The type of union they formed was an **industrial union**, an organization of both skilled and unskilled workers in a single industry. Soon workers in the rubber, mining, newspaper, and communications industries were also organized into unions. Eventually, these unions left the AFL and formed the *Congress of Industrial Organizations* (CIO).

During the same time (the late 1930s), there was a major upswing in rank-and-file membership in the AFL, the CIO, and independent unions. Strong union leadership, the development of effective negotiating tactics, and favorable legislation combined to increase total union membership to 9 million in 1940. At that point, the CIO began to rival the AFL in size and influence. There was another bitter rivalry: The AFL and CIO often clashed over which of them had the right to organize and represent particular groups of employees.

After World War II, the labor scene went through a number of changes. For one thing, during and after the war years there was a downturn in public opinion regarding unions. A few isolated but very visible strikes during the war caused public sentiment to shift against unionism. Perhaps the most significant occurrence, however, was the merger of the AFL and the CIO. After years of bickering, the two groups recognized that they were wasting effort and resources by fighting each other and that a merger would greatly increase the strength of both. The merger took place on December 5, 1955. The resulting organization, called the AFL-CIO, had a membership of as many as 16 million workers, which made it the largest labor organization of its kind in the world. Its first president was George Meany, who served until 1979.

✓ Concept Check

- What are some of the reasons for the early development of labor unions in the United States?
- Describe the historical development of labor unions in the United States.

18-2 Organized Labor Today

Learning Objective

18-2 Discuss trends in union membership.

The power of unions to negotiate effectively with management is derived from two sources. The first is their membership. The more workers a union represents within an industry, the greater is its clout in dealing with organizations operating in that industry. The second source of union power is the group of laws that guarantee unions the right to negotiate and, at the same time, regulate the negotiating process.

18-2a **Union Membership**

Approximately 10.8 percent of the nation's workers belong to unions. The rate of unionization is about five times higher for workers in the public sector than in the private sector.[2] The AFL-CIO is still the largest union organization in this country, boasting nearly 12.5 million members representing hundreds of smaller unions.[3]

industrial union an organization of both skilled and unskilled workers in a single industry

Unions evolve to address new challenges. When unions began, they could not have foreseen the rise of the gig economy and the issues faced by ride-hailing and delivery drivers on the job. Many drivers have joined unions fighting to be recognized as employees rather than independent contractors so that they can receive a higher minimum wage and benefits.

MEMO TO WALL ST ALL WORKERS SUPPORT UBER & LYFT DRIVERS!
UBER DECENT PAY & BENEFITS FOR DRIVERS!
WORKERS OF THE WORLD SUPPORT UBER & LYFT DRIVERS!
FIGHT WALL ST! SOLIDARITY WITH GIG WORKERS workersolidarity.net
WORKERS OF THE WORLD SUPPORT UBER & LYFT DRIVERS
NYC People's Power Assemblies • WorkersSolidarity.net

CORY SEAMER/SHUTTERSTOCK.COM

Those represented by the AFL-CIO include actors, barbers, construction workers, carpenters, retail clerks, musicians, teachers, postal workers, painters, steel and iron workers, firefighters, bricklayers, and newspaper reporters.

One of the largest unions not associated directly with the AFL-CIO is the *International Brotherhood of Teamsters (IBT)* union. The Teamsters originally were part of the AFL-CIO, but they were expelled in 1957 for corrupt and illegal practices. The Teamsters later rejoined the AFL-CIO in 1987, but left again in 2005. The Teamsters Union started out as an organization of professional drivers, but it now includes members in a variety of trades and professions in both the private and public sectors. Current membership is about 1.3 million workers.[4]

Another large union unaffiliated with the AFL-CIO is the *National Education Association (NEA)*, which is made up of nearly 3 million teachers and education support staff across the United States.[5] The *Service Employees International Union (SEIU)* comprises about 2 million service and healthcare workers.[6] Other large unions that are part of the AFL-CIO include the *American Federation of State, County, and Municipal Employees (AFSCME)*; the *American Federation of Teachers (AFT)*; the *United Food and Commercial Workers International (UFCW)*; the *United Steelworkers (USW)*; and the *International Union, United Automobile, Aerospace and Agricultural Implement Workers of America* (better known as *United Auto Workers or UAW*).

The proportion of union members relative to the size of the nation's workforce has declined over the last 30 years. Moreover, total union membership has dropped since 1980, despite steadily increasing membership in earlier years (refer to Figure 18-l). Several factors have contributed to this decline in membership. Heavily unionized industries either have been decreasing in size or have not been growing as fast as nonunionized industries. For example, cutbacks in the steel industry have tended to reduce union membership. At the same time, the growth of high-tech industries has increased the ranks of nonunion workers. Many companies have moved from the heavily unionized Northeast and Great Lakes regions to the less-unionized Southeast and Southwest regions—the so-called Sunbelt. At the relocated plants, formerly unionized firms tend to hire nonunion workers. The largest growth in employment is occurring in the service industries, and these industries typically are not unionized. Some U.S. companies have moved their manufacturing operations to other countries where less-unionized labor is employed. Unions are therefore turning their attention to industries that have not traditionally been organized to expand. In recent years, they have used employee dissatisfaction at a number of companies to mount protests, strikes, and organizing efforts to support employees of Amazon, Target, Walmart, FedEx, and Instacart.[7]

A recent study on union participation rates found a negative correlation between union participation and wage inequality. Decades ago, when unions were strong and roughly 1 in 3 workers were union members, they were able to exert a powerful influence over maintaining high wages. The study found that the largest factor contributing to union decline has been the growth of jobs outside of traditionally unionized industries, such as manufacturing and construction. The study also found that, even in unionized industries, managers have increasingly grown opposed to union activity.[8]

18-2b **Union-Management Partnerships**

For most of the 20th century, unions represented workers with respect to wages and working conditions. To obtain rights for workers and recognition for themselves, unions engaged in often-antagonistic negotiation sessions and strikes. At the same time, management traditionally protected its own rights of decision making, workplace organization, and strategic planning. Increasingly, however, managers have recognized that this traditionally adversarial relationship does not result in the kind of high-performance workplace and empowered workforce necessary to succeed in today's highly competitive global markets. For their part, unions and their members acknowledge that most major strikes result in failures that cost

Technology and Innovation

Unions Take on Big Tech

Until recently, unions have been a rarity in the technology industry. Although union membership is low in tech, technology is one of the fastest-growing job industries. For example, according to the Bureau of Labor Statistics, data scientists and mathematical science occupations are expected to grow by more than 30 percent in the next decade. Now, unions are making waves in Big Tech as the labor movement gains momentum.

Unions have taken key steps toward organizing in large companies as well as small start-ups. For example, following increasing calls for policy changes related to pay, harassment, and ethics, hundreds of Google employees voted to form the Alphabet Workers Union, which now represents more than 800 individuals. Similarly, employees at Glitch, a project management software start-up, voted to join the Communications Workers of America Local 1101. A year later, Glitch signed an 11-month collective bargaining agreement with unionized employees detailing severance and rehiring plans for laid-off employees. According to the union, the agreement was the first collective bargaining agreement signed by software engineers in the tech industry.

Employees at tech companies such as Salesforce and Pinterest have become more vocal about important issues such as diversity, discrimination, and harassment. Tech companies, however, have fought hard to prevent labor unions from gaining a foothold. Labor experts suggest that the growing labor movement in Big Tech is a result of the maturing of the tech industry and changing attitudes toward unionization among young workers.

Sources: Based on information in Brian Heater, "The Rise of the Tech Workers Union and What Comes Next," *TechCrunch*, March 8, 2021, www.techcrunch.com/2021/03/08/the-rise-of-the-tech-workers-union-and-what-comes-next; David Streitfeld, "How Amazon Crushes Unions," *The New York Times*, March 16, 2021, www.nytimes.com/2021/03/16/technology/amazon-unions-virginia.html; Ina Fried, "Tech's Union Push," *Axios*, February 5, 2021, www.axios.com/tech-companies-union-push-26b9029d-f451-4839-8410-7123f1095178.html; U.S. Bureau of Labor Statistics, "Employment Projections: Fastest Growing Occupations," April 9, 2021, www.bls.gov/emp/tables/fastest-growing-occupations.htm.

From conflict to cooperation. Traditionally, labor-management relations have been contentious. However, over the years, many organizations and unions have learned that cooperation is the key to the success of both groups.

STEVE CUKROV/SHUTTERSTOCK.COM

members thousands of jobs and reduce the unions' credibility. Today, instead of maintaining an "us versus them" mentality, many unions are striving to become partners with management and cooperating to enhance the workplace, empower workers, increase production, improve quality, and reduce costs. According to the Department of Labor, the number of union-management partnerships in the United States is increasing.

Union-management partnerships can be initiated by union leaders, employees, or management. *Long-range strategic partnerships* focus on sharing decision-making power for a whole range of workplace and business issues. Long-range partnerships sometimes begin as limited ones and develop slowly over time. *Limited partnerships* center on accomplishing one specific task or project, such as the introduction of teams or the design of training programs. Education remains an industry that has relatively high union participation rates. Yale University, for instance, has a long-range strategic partnership with employees who belong to the Unite Here Locals 34 and 35 labor unions. This arrangement helps the two parties to develop best practices, as well as providing a forum to solve disputes and agree on contracts.[9]

Although strategic union-management partnerships vary, most of them have several characteristics in common. First, strategic partnerships focus on developing cooperative relationships between unions and management instead of arguing over labor contract issues. Second, partners work toward mutual gain, in which the organization becomes more competitive, employees are better off, and unions are stronger as a result of the partnership. Finally, as already noted, strategic partners engage in joint decision making on a broad array of issues. These issues include performance expectations, organizational structure, strategic alliances, new technology, pay and benefits, employee security and involvement, union-management roles, product development, and education and training.

Good labor-management relations can help everyone to deal with new and difficult labor issues as they develop. For example, many companies hope that their union-management partnerships will be strong enough to deal with the critical issue of rising healthcare costs. Unions work hard to protect their members from having to pay an increased percentage of healthcare costs. They have experienced some success, in that civilian union workers pay on average about 21 percent of their healthcare premiums compared with nonunion workers' contributions of about 36 percent.[10] Strong union-management partnerships will play a vital role in resolving healthcare issues.

Union-management partnerships have many potential benefits for management, workers, and unions. For management, partnerships can result in lower costs, increased revenue, improved product quality, and greater customer satisfaction. For workers, benefits may include increased response to their needs, more decision-making opportunities, less supervision, more responsibility, and increased job security. Unions can gain credibility, strength, and increased membership.

Among the many organizations that have found union-management partnerships beneficial is Kaiser Permanente, a healthcare company. The Labor Management Partnership with 30 local unions representing 132,000 employees has helped Kaiser Permanente address challenges in the healthcare industry for 25 years. The partnership, which gives employees a greater say in workplace decisions and greater job security, provides problem-solving and performance-boosting tools that have helped teams simplify work processes, reduce waste, and improve performance. Collaboration among the partners ultimately resulted in such positive changes as fewer patient falls while hospitalized and higher hospital satisfaction.[11]

✓ Concept Check

- What factors have contributed to the decline of membership in unions?
- Describe the different types of relationships between unions and management.

Sustaining the Planet

BlueGreen Alliance Unites Unions with Environmental Organizations

The BlueGreen Alliance Foundation is a nonprofit organization that brings together labor unions and environmental organizations to tackle environmental issues in a way that supports both the economy and the planet. The coalition, made up of six labor unions and six national environmental groups, conducts research and engages in the education of the public and the media to achieve its mission. Members include national groups such as the Sierra Club and the Natural Resources Defense Council as well as labor unions such as the Service Employees International Union and the American Federation of Teachers.

The BlueGreen Alliance's Solidarity for Climate Action platform, a comprehensive plan to grow the clean energy economy, strives to create good-paying union jobs and fight income inequality by addressing climate issues. According to Collin O'Mara, president and CEO of the National Wildlife Federation, the platform will "demonstrate that smart climate action supports both family-sustaining jobs and healthy natural resources." The platform calls for the rapid reduction of greenhouse gas emissions to reach net-zero by 2050 and investments in renewable technology and energy efficiency. It also supports efforts to increase union density in the United States.

The alliance suggests that reducing pollution, improving infrastructure, building communities, expanding the public sector workforce, and moving to a net-zero emissions economy will provide better jobs, improve the lives of working families, and protect people from the worst impacts of climate change. Additionally, the alliance's climate action framework strives to address income inequality by calling for high-quality employment, training, and advancement opportunities for workers from low-income households, historically underrepresented individuals, and those adversely affected or dislocated by technological change.

Climate groups such as the BlueGreen Alliance attempt to influence public policy. The alliance does this by bringing labor and the environment together to foster unity under a shared vision. Beyond the Solidarity for Climate Action platform, the BlueGreen Alliance promotes restoring forests and wildlands, reducing employee misclassification, making it easier for individuals to unionize, investing in deindustrialized areas, and implementing universal high-speed internet.

Sources: Based on information in BlueGreen Alliance, "Labor, Environmental Leaders Release Historic 'Solidarity for Climate Action' Platform," June 24, 2019, www.bluegreenalliance.org/the-latest/labor-environmental-leaders-release-historic-solidarity-for-climate-action-platform; Rachel M. Cohen, "Climate Groups Begin Vying For Power in the Biden Era as Pressure for Unity Fades," *The Intercept*, January 21, 2021, www.theintercept.com/2021/01/21/bluegreen-alliance-biden-climate; David Robert, "At Last, A Climate Policy Platform That Can Unite the Left," *Vox*, July 9, 2020, www.vox.com/energy-and-environment/21252892/climate-change-democrats-joe-biden-renewable-energy-unions-environmental-justice.

18-3 Labor-Management Legislation

Learning Objective

18-3 Identify the main focus of several major pieces of labor-management legislation.

As we have noted earlier, business opposed early efforts to organize labor. The federal government generally supported anti-union efforts through the court system, and in some cases federal troops were used to end strikes. Gradually, however, the government began to correct this imbalance through the legislative process.

18-3a Norris-LaGuardia Act

The first major piece of legislation to secure rights for unions, the *Norris-LaGuardia Act* of 1932, was considered a landmark in labor-management relations. This act made it difficult for businesses to obtain court orders that banned strikes, picketing, or union membership drives. Previously, courts had issued such orders readily as a means of curbing these activities.

18-3b National Labor Relations Act

The *National Labor Relations Act,* also known as the *Wagner Act*, was passed by Congress in 1935. It established procedures by which employees decide whether they want to be represented by a union. If workers choose to be represented, the Wagner Act requires management to negotiate with union representatives. Before this law was passed, union efforts sometimes were interpreted as violating the Sherman Act (1890) because they were viewed as attempts to monopolize. The Wagner Act also forbid certain unfair labor practices on the part of management, such as firing or punishing workers because they were pro-union, spying on union meetings, and bribing employees to vote against unionization.

Finally, the Wagner Act established the **National Labor Relations Board (NLRB)** to enforce the provisions of the law. The NLRB is concerned primarily with (1) overseeing the elections in which employees decide whether they will be represented by a union and (2) investigating complaints lodged by unions or employees. Recently, the NLRB ruled that Tesla engaged in unfair labor practices such as questioning employees about their organizing efforts, threatening them with loss of potentially lucrative stock options if they tried to form a union, and firing an employee for organizing activities. The board required Tesla to rehire the fired employee and post a detailed notice of its violations; it also ruled that Tesla founder Elon Musk must delete an anti-union tweet.[12]

18-3c Fair Labor Standards Act

In 1938, Congress enacted the *Fair Labor Standards Act*. One major provision of this act permits the federal government to set a minimum wage. The first minimum wage, which was set in the late 1930s and did not include farm workers and retail employees, was $0.25 an hour. Today, the national minimum wage is $7.25 an hour, although many states and cities set their own minimum wages to account for differences in costs of living. California and Washington, DC, have the highest minimum wage in the nation at $14 and $15 an hour, respectively.[13] Some employees, such as waitpersons and farm workers, are still exempt from the minimum-wage provisions in most states. The act also requires that employees be paid overtime rates for work in excess of 40 hours a week. Finally, it prohibits the use of child labor.

18-3d Labor-Management Relations Act

National Labor Relations Board (NLRB) the federal agency that enforces the provisions of the Wagner Act

The legislation of the 1930s sought to discourage unfair practices on the part of employers. Recall from Figure 18-1 that union membership grew from approximately 2 million in 1910 to almost 12 million by 1945. Unions represented more than

35 percent of all nonagricultural employees in 1945. As union membership and power grew, however, the federal government began to scrutinize the practices of labor. Several long and bitter strikes in the 1940s, mainly in the coal mining and trucking industries, led to a demand for legislative restraint on unions. As a result, in 1947 Congress passed the *Labor-Management Relations Act,* also known as the *Taft-Hartley Act,* over President Harry Truman's veto.

The Taft-Hartley Act's objective is to provide a balance between union power and management authority. It specifies unfair labor practices that unions are forbidden to use, such as refusal to bargain with management in good faith, charging excessive membership dues, harassing nonunion workers, and using various means of coercion against employers.

The Taft-Hartley Act also gives management more rights during union organizing campaigns. For example, management may outline for employees the advantages and disadvantages of union membership, as long as the information it presents is accurate. The act gives the president of the United States the power to obtain a temporary injunction to prevent or stop a strike that endangers national health and safety. An **injunction** is a court order requiring a person or group either to perform some act or to refrain from performing some act. Finally, the Taft-Hartley Act authorized states to enact laws to allow employees to work in a unionized firm without joining the union. Currently, 28 states and territories (many in the south) have passed such *right-to-work laws.*[14]

18-3e **Landrum-Griffin Act**

In the 1950s, Senate investigations and hearings exposed racketeering in unions and uncovered cases of bribery, extortion, and embezzlement among union leaders. It was revealed that a few union leaders had taken union funds for personal use and accepted payoffs from employers for union protection. Some were involved in arson, blackmail, and murder. Public pressure for reform resulted in the 1959 *Landrum-Griffin Act.*

This law was designed to regulate the internal functioning of labor unions. Provisions of the law require unions to file annual reports with the U.S. Department of Labor regarding their finances, elections, and various decisions made by union officers. The Landrum-Griffin Act also ensures that every union member has the right to seek, nominate, and vote for each elected position in their union. It provides safeguards governing union funds, and it requires management and unions to report the lending of management funds to union officers, union members, or local unions.

The various pieces of legislation we have reviewed here effectively regulate much of the relationship between labor and management after a union has been established. The next section demonstrates that forming a union is also a carefully regulated process.

✓ Concept Check

- In what ways does labor-management legislation protect union workers?
- How do labor legislation acts affect a company's work environment?
- Describe the different labor acts and what their purposes are.

18-4 The Unionization Process

Learning Objective

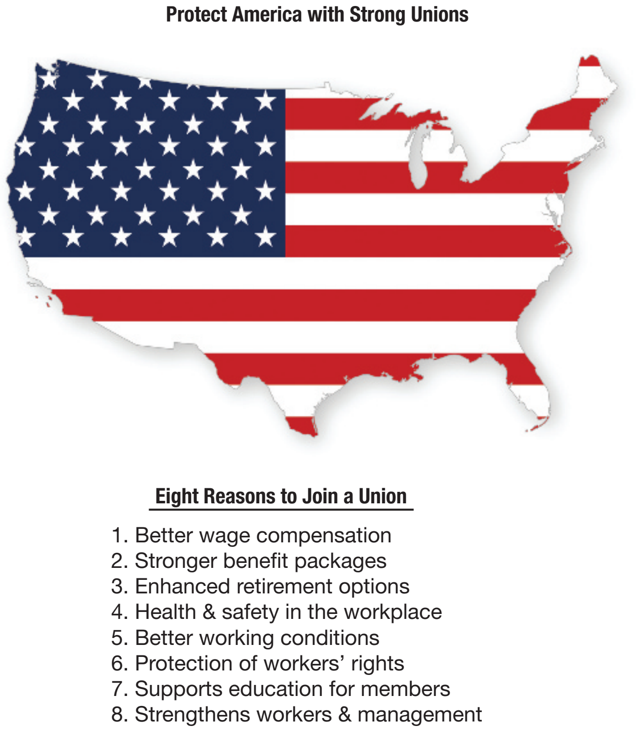
18-4 Explain the process involved in forming a union.

Before a union can be formed at a particular organization, some employees of the firm must be interested in being represented by a union. Then, they must take a number of steps to formally declare their desire for a union. To ensure fairness, most of the steps in this unionization process are supervised by the NLRB.

18-4a **Why Some Employees Join Unions**

Obviously, employees start or join a union for a variety of reasons. In many industries, such as teaching, union membership is so prevalent that new employees may feel compelled to join. In some states, even those employees who choose not

injunction a court order requiring a person or group either to perform some act or to refrain from performing some act


Protect America with Strong Unions

Eight Reasons to Join a Union

1. Better wage compensation
2. Stronger benefit packages
3. Enhanced retirement options
4. Health & safety in the workplace
5. Better working conditions
6. Protection of workers' rights
7. Supports education for members
8. Strengthens workers & management

ANGEL_AMX/SHUTTERSTOCK.COM

Want to join a union? There are several general reasons why workers join unions. Clearly, there are additional reasons for joining a union related to the characteristics of a specific company, industry practices, and a worker's individual needs.

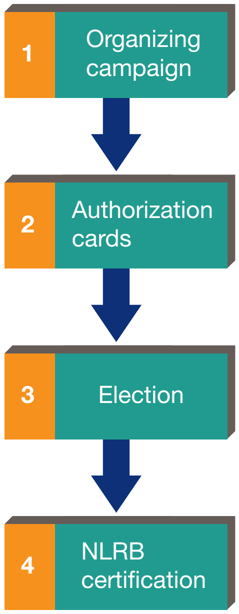
to join a union are required to pay union dues, which is a serious incentive to join.[15] Another commonly cited reason for joining a union is to combat a feeling of alienation. Some employees—especially those whose jobs are dull and repetitive—may perceive themselves as merely parts of a machine. They may feel that they lose their individual or social identity at work. Union membership is one way to establish contact with others in an organization.

Another common reason for joining a union is the perception that union membership increases job security. No one wants to live in fear of arbitrary or capricious dismissal from a job. Unions actually have only limited ability to guarantee a member's job, but they can help to increase job security by enforcing seniority rules. Employees may also join a union because of dissatisfaction with one or more elements of their jobs. If they are unhappy with their pay, benefits, or working conditions, they may look to a union to correct the perceived deficiencies. Workers at FedEx, for example, have considered joining the Teamsters because they feel that their benefits are less than those employed by United Parcel Service (UPS).[16]

Some people join unions because of their personal backgrounds. For example, a person whose parents are strong believers in unions might be inclined to feel just as positive about union membership.

In some situations, employees must join a union to keep their jobs. Many unions try, through their labor contracts, to require that a firm's new employees join the union after a specified probationary period. Under the Taft-Hartley Act, states may pass right-to-work laws prohibiting this practice.

Figure 18-2 Steps in Forming a Union



18-4b Steps in Forming a Union

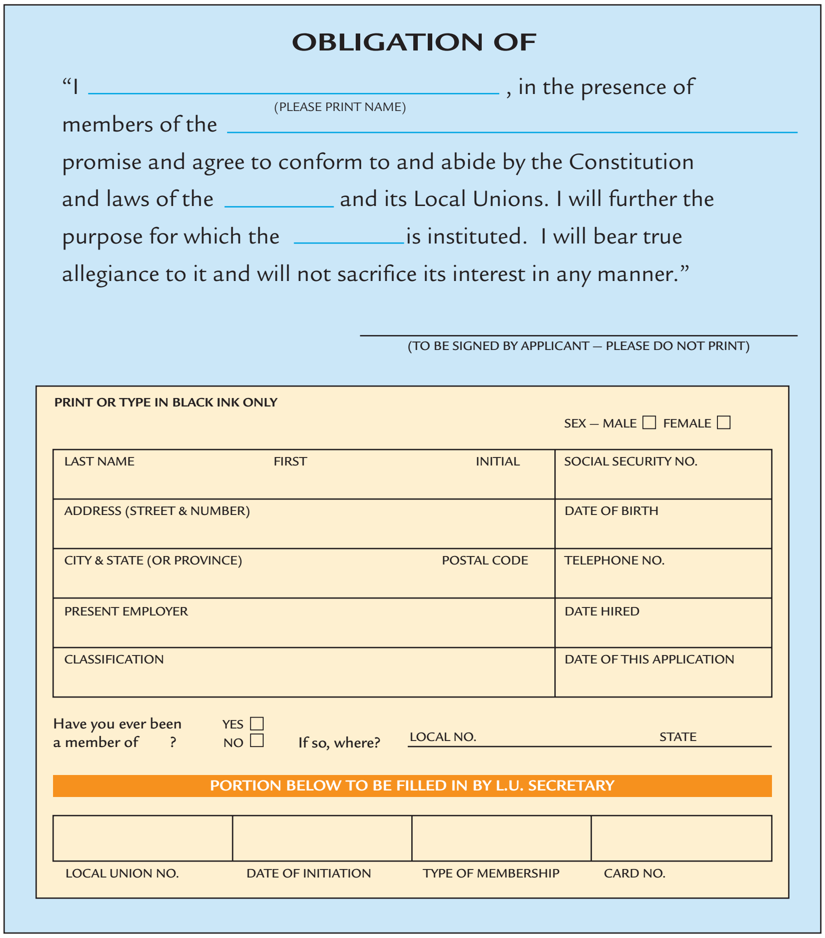
The first step in forming a union is the *organizing campaign* (refer to Figure 18-2). Its primary objective is to develop widespread employee interest in having a union. To kick off the campaign, a national union may send organizers to the firm to stir this interest. Alternatively, the employees themselves may decide that they want a union. Then they contact the appropriate national union and ask for organizing assistance.

The organizing campaign can be quite emotional, and it may lead to conflict between employees and management. On the one hand, the employees who want the union will be dedicated to its creation. On the other hand, management will be extremely sensitive to what it sees as a potential threat to its power and control.

At some point during the organizing campaign, employees are asked to sign *authorization cards* (refer to Figure 18-3) to indicate—in writing—their support for the union. Because of various NLRB rules and regulations, both union organizers and company management must be especially careful in their behavior during this authorization drive. For example, employees cannot be asked to sign the cards during times when they are supposed to be working. Managers may not indicate in any way that employees' jobs or job security will be in jeopardy if they do sign the cards.

If at least 30 percent of the eligible employees sign authorization cards, the organizers generally request that the company recognize the union as the employees'

Figure 18-3 Sample Authorization Card



OBLIGATION OF

“I ______________________________ , in the presence of
(PLEASE PRINT NAME)
members of the ____
promise and agree to conform to and abide by the Constitution
and laws of the ________ and its Local Unions. I will further the
purpose for which the ________ is instituted. I will bear true
allegiance to it and will not sacrifice its interest in any manner.”

____
(TO BE SIGNED BY APPLICANT — PLEASE DO NOT PRINT)

PRINT OR TYPE IN BLACK INK ONLY

SEX — MALE ☐ FEMALE ☐

LAST NAME	FIRST	INITIAL	SOCIAL SECURITY NO.
ADDRESS (STREET & NUMBER)			DATE OF BIRTH
CITY & STATE (OR PROVINCE)		POSTAL CODE	TELEPHONE NO.
PRESENT EMPLOYER			DATE HIRED
CLASSIFICATION			DATE OF THIS APPLICATION

Have you ever been a member of ? YES ☐ NO ☐ If so, where? LOCAL NO. ________ STATE ________

PORTION BELOW TO BE FILLED IN BY L.U. SECRETARY

LOCAL UNION NO.	DATE OF INITIATION	TYPE OF MEMBERSHIP	CARD NO.

bargaining representative. Usually the firm rejects this request, and a *formal election* is held to decide whether to have a union. This election usually involves secret ballots and is conducted by the NLRB. The outcome of the election is determined by a simple majority of eligible employees who choose to vote.

If the union obtains a majority, it becomes the official bargaining agent for its members, and the final step, *NLRB certification,* takes place. The union may immediately begin the process of negotiating a labor contract with management. If the union is voted down, the NLRB will not allow another election for one year.

Several factors can complicate the unionization process. For example, the **bargaining unit**, which is the specific group of employees that the union is to represent, must be defined. Union organizers may want to represent all hourly employees at a particular site (such as all workers at a manufacturing plant), or they may wish to represent only a specific group of employees (such as all electricians in a large manufacturing plant).

Another issue that may have to be resolved is **jurisdiction**, which is the right of a particular union to organize particular groups of workers (such as nurses). When jurisdictions overlap or are unclear, the employees themselves may decide who will represent them. In some cases, two or more unions may be trying to organize some or all of the employees of a firm. Then, the election choices may be union A, union B, or no union at all.

bargaining unit the specific group of employees represented by a union

jurisdiction the right of a particular union to organize particular groups of workers

18-4c **The Role of the NLRB**

As we have discussed, the NLRB is deeply involved in the unionization process. Generally, the NLRB is responsible for overseeing the organizing campaign, conducting the election (if one is warranted), and certifying the election results.

During the organizing campaign, both employers and union organizers can take steps to educate employees regarding the advantages and disadvantages of having a union. However, neither is allowed to use underhanded tactics or to distort the truth. If violations occur, the NLRB can stop the questionable behavior, postpone the election, or set aside the results of an election that has already taken place. For example, the NLRB set aside an election to organize employees at Cleveland-based Ace Heating and Air Conditioning Co. after it ruled that management had threatened to close the business if employees voted to join the Sheet Metal Workers International union. The NLRB ordered a new election.[17]

The NLRB usually conducts the election within 45 days of receiving the required number of signed authorization cards from the organizers. A very high percentage of the eligible voters generally participate in the election, and it is held at the workplace during normal working hours. In certain cases, however, a mail ballot or some other form of election may be called for.

Certification of the election involves counting the votes and considering challenges to the election. After the election results are announced, management and the union organizers have five days to challenge the election. The basis for a challenge might be improper conduct before the election or participation by an ineligible voter. After considering any challenges, the NLRB passes final judgment on the election results.

When union representation is established, union and management get down to the serious business of contract negotiations.

✓ Concept Check

- Describe the steps of the unionization process.
- What events must occur before the NLRB certification can take place?
- Why do people choose to join unions?

18-5 Collective Bargaining

Learning Objective

18-5 Describe the basic elements of the collective-bargaining process.

Once certified by the NLRB, a new union's first task is to establish its own identity and structure. It immediately signs up as many members as possible. Then, in an internal election, members choose officers and representatives. A negotiating committee is also chosen to begin **collective bargaining**, the process of negotiating a labor contract with management.

18-5a **The First Contract**

To prepare for its first contract session with management, the negotiating committee decides on its position on the various contract issues and determines the issues that are most important to the union's members. For example, the two most pressing concerns might be a general wage increase and an improved benefits package. The union then informs management that it is ready to begin negotiations, and the two parties agree on a time and location. Both sides continue to prepare for the session up to the actual date of the negotiations.

Negotiations are occasionally held on company premises, but it is more common for the parties to meet away from the workplace—perhaps in a local hotel. The union typically is represented by the negotiating committee and one or more officials from the regional or national union office. The firm normally is represented by managers from the industrial-relations, operations, human resources management, and legal departments. Each side is required by law to negotiate in good faith and not to stall or attempt to extend the bargaining proceedings unnecessarily.

The union normally presents its contract demands first. Management then responds to the demands, often with a counterproposal. The bargaining

collective bargaining the process of negotiating a labor contract with management may move back and forth, from proposal to counterproposal, over a number of meetings. Throughout the process, union representatives constantly keep their members informed of what is going on and how the negotiating committee feels about the various proposals and counterproposals.

Each side clearly tries to "get its own way" as much as possible, but each also recognizes the need for compromise. For example, the union may begin the negotiations by demanding a wage increase of $1 per hour but may be willing to accept 60 cents per hour. Management initially may offer 40 cents but may be willing to pay 75 cents. Eventually, the two sides will agree on a wage increase of between 60 and 75 cents per hour.

Establish
Employees
Protection
Grievance
COLLECTIVE
BARGAINING
Salaries
Negotiation
Union
Productive
Agreement
Regulate
Working Hours
Healthcare
Representative
Wages
Fair
Group
Cost
Terms
Issues
Employment
Contract
Process
Health
Participate
Overtime
Salary
Employer
Cost

ROB WILSON/SHUTTERSTOCK.COM

If an agreement cannot be reached, the union may strike. However, strikes are rare during a union's first contract negotiations. In most cases, the negotiating teams are able to agree on an initial contract without resorting to a strike.

The final step in collective bargaining is **ratification**, which is approval of the contract by a vote of the union membership. If the membership accepts the terms of the contract, it is signed and becomes a legally binding agreement. If the contract is not ratified, the negotiators must go back and try to iron out a more acceptable agreement.

18-5b **Labor Contracts**

A labor contract may cover a period of one to three years or more, but every contract has an expiration date. As that date approaches, both management and the union begin to prepare for new contract negotiations. Now, however, the entire process is likely to be much thornier than the first negotiation.

For one thing, the union and the firm have "lived with each other" for several years, during which some difficulties may have emerged. Each side may see certain issues as being of critical importance—issues that provoke a great deal of emotion at the bargaining table and often are difficult to resolve. Also, each side has learned from the earlier negotiations. Each may take a harder line on certain issues and be less willing to compromise.

The contract deadline itself also produces tension. As the expiration date of the existing contract draws near, each side feels a pressure—real or imagined—to reach an agreement. This pressure may nudge the negotiators toward an agreement, but it also can have the opposite effect, making an accord more difficult to reach. Moreover, at some point during the negotiations, union leaders are likely to take a *strike vote*. This vote reveals whether union members are willing to strike in the event that a new contract is not negotiated before the old one expires. In almost all cases, this vote supports a strike. Thus, the threat of a strike may add to the pressure mounting on both sides as they go about the business of negotiating.

ratification approval of a labor contract by a vote of the union membership

✓ Concept Check

- Describe the different contracts involved in collective bargaining.
- What events during the collective bargaining process can result in a strike?

18-6 Union-Management Contract Issues

Learning Objective

18-6 Identify the major issues covered in a union-management contract.

As you might expect, many diverse issues are negotiated by unions and management and are incorporated into a labor contract. Unions tend to emphasize issues related to members' income, their standard of living, and the strength of the union. Management's primary goals are to retain as much control as possible over the firm's operations and to maximize its strength relative to that of the union. The balance of power between union and management varies from firm to firm.

18-6a Employee Compensation

An area of bargaining central to union-management relations is employee compensation. Three separate issues are usually involved: the forms of pay, the magnitude of pay, and the means by which the magnitude of pay will be determined.

Forms of Pay The primary form of pay is direct compensation—the wages or salaries and benefits employees receive in exchange for their contributions to the organization. Because direct compensation is a fairly straightforward issue, negotiators often spend much more of their time discussing a benefits package for employees. The range of benefits and their costs have escalated over the years, making this aspect of pay increasingly important and complex.

We discussed employee benefits in Chapter 9. Of these, health, life, disability, and dental insurance are important benefits that unions try to obtain for their members. As the costs of healthcare continue to soar, employers are spending significantly more on insurance benefits, and many are trying to pass a higher portion of this increased cost on to their employees. Deferred compensation, in the form of pension or retirement programs, is also a common focal point. Decisions about deferred compensation can have a long-lasting impact on a company.

Other benefits commonly dealt with in the bargaining process include paid time off (PTO), such as vacation days, holidays, and paid sick leave. Obviously, unions argue for as much paid vacation and holiday time as possible and for liberal sick-leave policies. Management naturally takes the opposite position. After decades of generous benefits packages, most firms have been forced to reduce them due to decreased revenues or increased expenses during recessionary periods. Moreover, as more and more Baby Boomers reach retirement age, pensions—which in some cases were underfunded—have become too expensive for many companies and governments to continue to sustain. Even heavily unionized industries, such as automobile manufacturing and utilities, have had to reduce or eliminate their pensions for younger workers.

Magnitude of Pay Of considerable importance is the *magnitude,* or amount, of pay that employees receive as both direct and indirect compensation. The union attempts to ensure that pay is on par with that received by other employees in the same or similar industries, both locally and nationally. The union also attempts to include in the contract clauses that provide pay increases over the life of the agreement. The most common is the *cost-of-living clause,* which ties periodic pay increases to increases in the cost of living, as defined by various economic statistics or indicators.

Of course, the magnitude of pay is also affected by the organization's ability to pay. If the firm has posted large profits recently, the union may expect large pay increases for its members. If the firm has not been very profitable, the union may agree to smaller pay hikes or even to a pay freeze. In an extreme situation (e.g.,

Exploring Careers

Union Workers Earn More, Yet Enrollment Has Declined

Although union enrollment has been on the decline for many years, workers who belong to unions earn 19 percent more than their nonunion counterparts, according to the U.S. Bureau of Labor Statistics. Nonunion workers have median weekly earnings of $958 while union workers earn $1,144. Additionally, a report from the Economic Policy Institute, an independent nonprofit that researches the impact of economic trends and policies on U.S. families, suggests that unionized workers have greater access to health insurance and paid sick days.

Overall union enrollment has declined for a variety of reasons, including anti-union sentiment from employers. A major contributing factor is that the industries where union participation has been historically high, such as manufacturing, have shrunk. Job growth today is stronger in industries such as technology where unions have traditionally been nonexistent.

Despite the decline in union enrollment, interest in labor unions seems to be on the rise. President Joseph R. Biden is pro-union and has outlined plans for strengthening unions to support a strong middle class. Wealth inequalities were put in the spotlight especially during the COVID-19 pandemic as workers organized, fighting for protections. There is also increasing interest in labor unions in growing industries. While high-profile unionization efforts have failed at some big companies such as Boeing and Nissan, there have been some successful campaigns, such as the Alphabet Workers Union, which now represents more than 800 Google employees.

Higher salaries, better benefits, job security, and bargaining power are some of the benefits of joining a union. The occupations with the highest concentrations of union workers include protective service occupations, education and library occupations, and construction and extraction occupations. As interest in unions increases, workers will have more opportunities to join these labor groups and seek union jobs.

Sources: Based on information in U.S. Bureau of Labor Statistics, “Union Members Summary,” January 22, 2021, www.bls.gov/news.release/union2.nr0.htm; Alison Doyle, “How to Get a Union Job,” *The Balance Careers*, July 21, 2020, www.thebalancecareers.com/how-to-get-a-union-job-2058802; Bobby Allyn, “Google Workers Speak Out About Why They Formed A Union: ‘To Protect Ourselves’,” *NPR*, January 8, 2021, www.npr.org/2021/01/08/954710407/at-google-hundreds-of-workers-formed-a-labor-union-why-to-protect-ourselves; Abigail Johnson Hess, “Union Enrollment Has Declined For Decades, but Union Workers Still Earn 19% More,” *CNBC*, February 5, 2021, www.cnbc.com/2021/02/05/union-enrollment-declined-for-decades-but-union-workers-still-earn-more.html.

when the firm is bordering on bankruptcy), the union may agree to pay cuts. Very stringent conditions usually are included in any agreement to a pay cut.

Bargaining with regard to magnitude also revolves around employee benefits. At one extreme, unions seek a wide range of benefits, entirely or largely paid for by the firm. At the other extreme, management may be willing to offer the benefits package but may want its employees to bear most of the cost. As an example, escalating healthcare costs have led most organizations to ask employees to take on at least part of the burden or rising health insurance premiums. Again, factors such as equity (with similar firms and jobs) and ability to pay enter into the final agreement.

Pay Determinants Negotiators also address the question of how individual pay will be determined. For management, the ideal arrangement is to tie wages to each employee’s productivity. As we have seen, this method of payment tends to motivate and reward effort. Unions, on the other hand, feel that this arrangement can create unnecessary competition among employees. They generally argue that employees should be paid—at least in part—according to seniority. **Seniority** is the length of time an employee has worked for an organization.

seniority the length of time an employee has worked for an organization

Determinants regarding benefits are also negotiated. For example, management may want to provide profit-sharing benefits only to employees who have worked for the firm for a specified number of years. The union may want these benefits provided to all employees.

18-6b Working Hours

The number of working hours is another important issue in contract negotiations. The matter of overtime is of special interest. Federal law defines **overtime** as time worked in excess of 40 hours in one week. It also specifies that overtime pay must be at least one-and-one-half times the normal hourly wage. Unions may also attempt to negotiate overtime rates for all hours worked beyond eight hours in a single day. Similarly, the union may attempt to obtain higher overtime rates (say, twice the normal hourly wage) for weekend or holiday work. Still another issue is an upper limit to overtime, beyond which employees can refuse to work.

In firms with two or more work shifts, workers on less desirable shifts are paid a premium for their time. Both the amount of the premium and the manner in which workers are chosen for (or choose) particular shifts are negotiable issues. Other issues related to working hours are the work starting times and the length of lunch periods and coffee breaks.

18-6c Security

Security actually covers two issues. One is the job security of the individual worker; the other is the security of the union as the bargaining representative of the firm's employees.

Job security is protection against the loss of employment. It is a major concern of individuals. As we noted earlier, the desire for increased job security is a major reason for joining unions in the first place. In the typical labor contract, job security is based on seniority. If employees must be laid off or dismissed, those with the least seniority are the first to go. Some of the more senior employees may have to move to lower-level jobs, but they remain employed.

Union security is protection of the union's position as the employees' bargaining agent. Union security is frequently a more volatile issue than job security. Unions strive for as much security as possible, but management tends to see an increase in union security as an erosion of its control.

Union security arises directly from its membership. The greater the ratio of union employees to nonunion employees, the more secure the union is. In contract negotiations, unions thus attempt to establish various union membership conditions. The most restrictive of these is the **closed shop**, in which workers must join the union before they are hired. This condition was outlawed by the Taft-Hartley Act, but several other arrangements, including the following, are subject to negotiation:

- The **union shop**, in which new employees must join the union after a specified probationary period.
- The **agency shop**, in which employees can choose not to join the union but must pay dues to the union anyway. (The idea is that nonunion employees benefit from union activities and should help to support them.)
- The **maintenance shop**, in which employees who join the union must remain union members as long as they are employed by the firm.

overtime time worked in excess of 40 hours in one week (under some union contracts, time worked in excess of eight hours in a single day)

job security protection against the loss of employment

union security protection of the union's position as the employees' bargaining agent

closed shop a workplace in which workers must join the union before they are hired; outlawed by the Taft-Hartley Act

union shop a workplace in which new employees must join the union after a specified probationary period

agency shop a workplace in which employees can choose not to join the union but must pay dues to the union anyway

maintenance shop a workplace in which employees who join the union must remain union members as long as they are employed by the firm

18-6d Management Rights

Of particular interest to the firm are those rights and privileges that are to be retained by management. The company generally wants as much control as possible over whom it hires, how work is scheduled, and how discipline is handled.

The union, in contrast, would like some control over these and other matters affecting its members. It is interesting that some unions are making progress toward their goal of playing a more direct role in corporate governance. Some union executives have, in fact, been given seats on corporate boards of directors.

18-6e **Grievance Procedures**

A **grievance procedure** is a formally established course of action for resolving employee complaints against management. Virtually every labor contract contains a grievance procedure. Procedures vary in scope and detail, but they may involve the four steps described as follows (refer to Figure 18-4).

Original Grievance The process begins with employees who believe that they have been treated unfairly in violation of the labor contract. For example, an employee may be entitled to a formal performance review after six months on the job. If no such review is conducted, the employee may file a grievance. To do so, the employee explains the grievance to a **shop steward**, an employee elected by union members to serve as their representative. The employee and the steward then discuss the grievance with the employee's immediate supervisor. Both the grievance and the supervisor's response are put in writing.

Broader Discussion In most cases, the problem is resolved during the initial discussion with the supervisor. If it is not, a second discussion is held. Now the participants include the original parties (employee, supervisor, and steward), a representative from the union's grievance committee, and the firm's industrial-relations representative. Again, a record is kept of the discussion and its results.

Full-Scale Discussion If the grievance is still not resolved, a full-scale discussion is arranged. This discussion includes everyone involved in the broader discussion, as well as all remaining members of the union's grievance committee and another high-level manager. As usual, all proceedings are put in writing. All participants are careful not to violate the labor contract during this attempt to resolve the complaint.

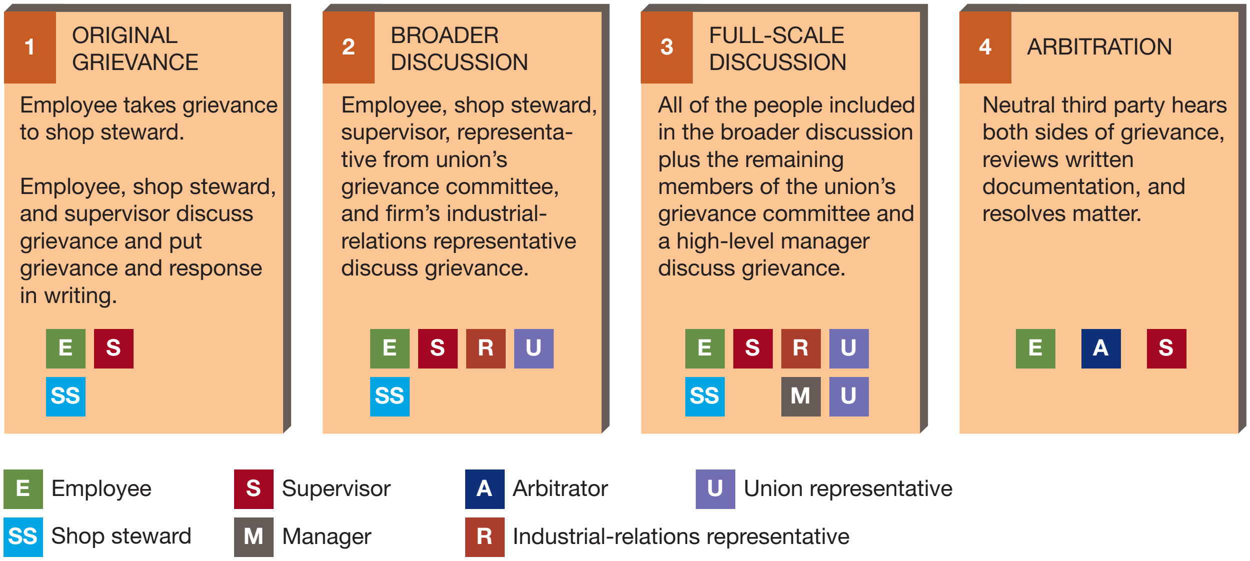
Arbitration The final step in a grievance procedure is **arbitration**, in which a neutral third party hears the two sides of a dispute and renders a binding decision.

grievance procedure a formally established course of action for resolving employee complaints against management

shop steward an employee elected by union members to serve as their representative

arbitration the step in a grievance procedure in which a neutral third party hears the two sides of a dispute and renders a binding decision

Figure 18-4 Steps in Resolving a Grievance



1 ORIGINAL GRIEVANCE

Employee takes grievance to shop steward.

Employee, shop steward, and supervisor discuss grievance and put grievance and response in writing.

2 BROADER DISCUSSION

Employee, shop steward, supervisor, representative from union's grievance committee, and firm's industrial-relations representative discuss grievance.

3 FULL-SCALE DISCUSSION

All of the people included in the broader discussion plus the remaining members of the union's grievance committee and a high-level manager discuss grievance.

4 ARBITRATION

Neutral third party hears both sides of grievance, reviews written documentation, and resolves matter.

E Employee	S Supervisor	A Arbitrator	U Union representative
SS Shop steward	M Manager	R Industrial-relations representative	

As in a court hearing, each side presents its case and has the right to cross-examine witnesses. In addition, the arbitrator reviews the written documentation of all previous steps in the grievance procedure. Both sides may then give summary arguments and/or present briefs. The arbitrator then decides whether a provision of the labor contract has been violated and proposes a remedy. The arbitrator cannot make any decision that would add to, detract from, or modify the terms of the contract. If it can be proved that the arbitrator exceeded the scope of the arbitrator's authority, either party may appeal the decision to the courts.

What actually happens when union and management "lock horns" over all the issues we have mentioned? We can answer this question by looking now at the negotiating tools each side can wield.

✓ Concept Check

- Describe the major issues addressed in labor contracts.
- What is the importance of including grievance procedures in a labor contract?

18-7 Union and Management Negotiating Tools

Learning Objective

18-7 Explain the primary bargaining tools available to unions and management.

Management and unions can employ certain tools to influence each other during contract negotiations. Both sides may use advertising and publicity to gain support for their respective positions. The most extreme tools are strikes and lockouts, but there are other, milder techniques as well.

18-7a Strikes

Unions only go out on strike in a very few instances. These almost always occur after an existing labor contract has expired. At GM, for example, 49,000 members of the United Auto Workers union went on strike at 33 GM plants when they could not reach an agreement with management over increased pay, job security, and a plan to make permanent jobs for temporary workers. The automaker wanted to reduce costs in order to remain competitive with automakers from other countries. The strike lasted about a month before the union and management negotiated a new contract.[18] Generally speaking, strikes have been on the decline. There were only eight major strikes in 2020, just a few more than the lowest documented number of five strikes in 2009.[19] Even then, if new contract negotiations seem to be proceeding

Picketing. Picketing is used to publicize that a strike is occurring.

TEACHERS FOR BETTER SCHOOLS FOR ALL STUDENTS
CHICAGO PUBLIC SCHOOLS ON STRIKE against UNFAIR LABOR PRACTICES
ON STRIKE for a FAIR CONTRACT
LOCAL 73
SEIU
Stronger Together
#FairContractNo
CHICAGO PUBLIC SCHOOLS
ON STRIKE
SOUTH

SUMMERLEE SCHMITT/SHUTTERSTOCK.COM

smoothly, a union does not actually start a strike. The union does take a strike vote, but the vote may be used primarily to show members' commitment to a strike if negotiations fail.

The main objective of a strike is to put financial pressure on the organization to encourage management to meet union demands. When union members do go out on strike, it is usually because negotiations seem to be stalled. As an example, the 25,000 members of the Chicago Teachers Union went on strike after months of negotiations proved unsuccessful. After the strike resulted in 11 days of canceled classes, the school district and union were able to reach an agreement that included pay raises for staff.[20]

A strike is simply a work stoppage: The employees do not report for work. In addition, striking workers engage in **picketing**, marching back and forth in front of a place of employment with signs informing the public that a strike is in progress. In doing so, they hope that (1) the public will be sympathetic to the strikers and will not patronize the struck firm, (2) nonstriking employees of the firm will honor the picket line and not report to work, and (3) members of other unions will not cross the picket line (e.g., to make deliveries) and thus will further restrict the operations of the struck firm. Unions may also engage in informational picketing to let companies know of their dissatisfaction.

Obviously, strikes are expensive to both the firm and the strikers. The firm loses business and earnings during the strike, and the striking workers lose the wages they would have earned if they had been at their jobs. During a strike, unions try to

picketing marching back and forth in front of a place of employment with signs informing the public that a strike is in progress

Ethics and Social Responsibility

United Auto Workers Union Corruption Scandal Skids to a Stop

A multiyear corruption probe into the United Auto Workers (UAW) union was one of the largest federal investigations into a national labor union in decades. The investigation resulted in several former UAW labor leaders facing prison time. The U.S. attorney's office in Detroit led the probe and uncovered a culture of corruption marked by kickback schemes, racketeering, embezzlement, and other illicit activities, according to federal prosecutors.

Investigators uncovered a plot between UAW officials and labor management at Fiat Chrysler to provide union leaders with gifts and money through a shared training center facility. They then discovered a kickback scheme at another facility shared with General Motors. The probe also found that two former union presidents embezzled union funds.

The scandal resulted in at least 15 convictions. The settlement with the Justice Department includes six years of independent oversight by a court-appointed monitor and requires the UAW to resolve outstanding tax issues, paying $1.5 million. By agreeing to the independent monitor, the UAW potentially avoided more aggressive interference by the government. "We are committed to making this monitor's job very boring," UAW president Rory Gamble said.

Gamble committed to reforming the union by hiring an ethics officer and taking other preventative measures to avoid ethical misconduct. Ethics officers are high-ranking individuals that are responsible for managing ethics and compliance programs. The UAW will also hold a vote among union members related to how top leadership is elected. In the current system, which potentially contributed to the union's organizational culture problems, leaders are chosen by officials in local chapters rather than the entire union. It is important for the UAW to restore both public and member trust. People rely on unions to put workers' financial interests ahead of their own. The union's enrollment has declined over the years, and federal scrutiny related to the scandal has not helped the UAW's reputation.

Sources: Based on information in Ben Foldy and Nora Naughton, "UAW Reaches Settlement With Feds in Multiyear Corruption Probe," *The Wall Street Journal*, December 14, 2020, www.wsj.com/articles/doj-reaches-civil-settlement-with-united-auto-workers-in-corruption-probe-11607957059; Breana Noble, "Despite Corruption Scandal and Pandemic, UAW Membership Steady," *The Detroit News*, March 29, 2021, www.detroitnews.com/story/business/autos/2021/03/29/united-auto-workers-membership-levels-steady-despite-scandal-covid/7048402002; United Auto Workers, "The United States Reaches a Settlement With the United Auto Workers Union to Reform the Union and End Corruption and Fraud," press release, December 14, 2020, www.uaw.org/united-states-reaches-settlement-united-auto-workers-union-reform-union-end-corruption-fraud.

provide their members with as much support as possible. Larger unions are able to put a portion of their members' dues into a *strike fund*. The fund is used to provide financial support for striking union members. At times, workers may go out on a **wildcat strike**, which is a strike that has not been approved by the union. In this situation, union leaders typically work with management to convince the strikers to return to work.

18-7b Slowdowns and Boycotts

Almost every labor contract contains a clause that prohibits strikes during the life of the contract. (This is why strikes, if they occur, usually take place after a contract has expired.) However, a union may strike a firm while the contract is in force if members believe that management has violated its terms. Workers also may engage in a **slowdown**, a technique whereby workers report to their jobs but work at a pace that is slower than normal. As an example, members of the International Longshore and Warehouse Union (ILWU) engaged in work slowdowns at four major West Coast ports after their contracts expired and collective bargaining talks reached an impasse. The slowdowns triggered congestion and backups at those ports, as well as nearby ones, resulting in shipping delays along the crucial U.S.-Asia trade route. After nine months without resolution, the U.S. president—spurred by concerns that further shipping delays would have a profound negative impact on the U.S. economy—sent in mediators to help the two sides resume negotiations.[21]

A **boycott** is a refusal to do business with a particular firm. Unions occasionally employ this strategy by urging members (and sympathizers) not to purchase the products of a firm with which they are having a dispute. The Teamsters, for example, called for its members to boycott Minnesota-based Red Wing Shoe Company in support of warehouse workers from its local union in their contract negotiations with the shoemaker. The local union had also called for a strike after its contract expired. The union ended the boycott after a new labor contract was signed.[22] A *primary boycott,* aimed at the employer directly involved in the dispute, can be a powerful weapon. A *secondary boycott,* aimed at a firm doing business with the employer, is prohibited by the Taft-Hartley Act. Cesar Chavez, a migrant worker who founded the United Farm Workers Union, used boycotts to draw attention to the low pay and awful conditions endured by produce pickers.

18-7c Lockouts and Strikebreakers

Management's most potent weapon is the **lockout**. In a lockout, the firm refuses to allow employees to enter the workplace. Like strikes, lockouts are expensive for both the firm and its employees. For this reason, they are only used rarely and in certain circumstances. A firm that produces perishable goods, for example, may use a lockout if management believes that its employees will soon go on strike. The idea is to stop production in time to ensure minimal spoilage of finished goods or work-in-process.

Management also may attempt to hire strikebreakers. A **strikebreaker** is a nonunion employee who performs the job of a striking union member. Hiring strikebreakers can result in violence when picketing employees confront the nonunion workers at the entrance to the struck facility. The firm also faces the problem of finding qualified replacements for the striking workers. Sometimes management personnel take over the jobs of strikers.

18-7d Mediation and Arbitration

Strikes, strikebreaking, lockouts, and boycotts all pit one side against the other. Ultimately, one side "wins" and the other "loses." Unfortunately, the negative effects of such actions—including resentment, fear, and distrust—may linger for months or

wildcat strike a strike not approved by the strikers' union

slowdown a technique whereby workers report to their jobs but work at a slower pace than normal

boycott a refusal to do business with a particular firm

lockout a firm's refusal to allow employees to enter the workplace

strikebreaker a nonunion employee who performs the job of a striking union member years after a dispute has been resolved. More productive techniques that are being used increasingly are mediation and arbitration. Either one may come into play before a labor contract expires or after some other strategy, such as a strike, has proved ineffective.

Mediation is the use of a neutral third party to assist management and the union during their negotiations. This third party (the mediator) listens to both sides, trying to find common ground for agreement. The mediator also tries to facilitate communication between the two sides, promote compromise, and generally keep the negotiations moving. At first the mediator may meet privately with each side. Eventually, however, the goal of the mediator is to get the two sides back to the table to resolve their differences. The Federal Mediation and Conciliation Service (FMCS) is an independent government agency that handles mediation for labor disputes. In its 2020 fiscal year, the agency mediated more than 4,500 collective-bargaining and grievance negotiations as well as 1,500 alternative dispute resolution cases. It also held 1,675 training programs.[23]

Unlike mediation, the *arbitration* step is a formal hearing. Just as it may be the final step in a grievance procedure, it also may be used in contract negotiations (perhaps after mediation attempts) when the two sides cannot agree on one or more issues. Here, the arbitrator hears the formal positions of both parties on outstanding, unresolved issues. The arbitrator then analyzes these positions and makes a decision on the possible resolution of the issues. If both sides have agreed in advance that the arbitration will be *binding*, they must accept the arbitrator's decision.

✓ Concept Check

- In what ways do labor unions gain support for their mission?
- Describe the differences in negotiating tools between unions and management.

mediation the use of a neutral third party to assist management and the union during their negotiations

Summary

18-1 Explain how and why labor unions came into being.

A labor union is an organization of workers who act together to negotiate wages and working conditions with their employers. Labor relations are the dealings between labor unions and business management.

The first major union in the United States was the Knights of Labor, formed in 1869 to eliminate the depersonalization of workers. The Knights were followed in 1886 by the American Federation of Labor (AFL). The goal of the AFL was to improve its members' living standards without changing the business system. In 1905, the radical Industrial Workers of the World (IWW) was formed; its goal was to overthrow capitalism. Of these three, only the AFL remained when the Congress of Industrial Organizations (CIO) was founded as a body of industrial unions between World War I and World War II. After years of competing, the AFL and CIO merged in 1955. The largest union not affiliated with the AFL-CIO is the Teamsters Union.

18-2 Discuss trends in union membership.

The power of unions to negotiate with management comes from two sources. The first is the size of their membership. The second is the group of laws that guarantee unions the right to negotiate and that regulate the negotiation process. At present, union membership accounts for less than 12 percent of the American workforce, and it seems to be decreasing for various reasons. Nonetheless, unions wield considerable power in many industries—those in which their members comprise a large proportion of the workforce.

Many unions today are entering into partnerships with management rather than maintaining their traditional adversarial position. Unions and management cooperate to increase production, improve quality, lower costs, empower workers, and enhance the workplace. Limited partnerships center on accomplishing one specific task or project. Long-range strategic partnerships focus on sharing decision-making power for a range of workplace and business matters.

18-3 Identify the main focus of several major pieces of labor-management legislation.

Important laws that affect union power are the Norris-LaGuardia Act (limits management's ability to obtain injunctions against unions), the Wagner Act (forbids certain unfair labor practices by management), the Fair Labor Standards Act (allows the federal government to set the minimum wage and to mandate overtime rates), the Taft-Hartley Act (forbids certain unfair practices by unions), and the Landrum-Griffin Act (regulates the internal functioning of labor unions). The National Labor Relations Board (NLRB), a federal agency that oversees union-management relations, was created by the Wagner Act.

18-4 Explain the process involved in forming a union.

Attempts to form a union within a firm begin with an organizing campaign to develop widespread employee interest in having a union. Next, employees sign authorization cards, indicating in writing their support for the union. The third step is to hold a formal election to decide whether to have a union. Finally, if the union obtains a majority, it receives NLRB certification, making it the official bargaining agent for its members. The entire process is supervised by the NLRB, which oversees the organizing campaign, conducts the election, and certifies the election results.

18-5 Describe the basic elements of the collective-bargaining process.

Once a union is established, it may negotiate a labor contract with management through the process of collective bargaining. First, the negotiating committee decides on its position on the various contract issues. The union informs management that it is ready to begin negotiations, and a time and place are set. The union is represented by the negotiating committee, and the organization is represented by managers from several departments in the company. Each side is required to negotiate in good faith and not to stall or attempt to extend the bargaining unnecessarily. The final step is ratification, which is approval of the contract by a vote of the union membership.

18-6 Identify the major issues covered in a union-management contract.

As the expiration date of an existing contract approaches, management and the union begin to negotiate a new contract. Contract issues include employee pay and benefits, working hours, job and union security, management rights, and grievance procedures.

18-7 Explain the primary bargaining tools available to unions and management.

Management and unions can use certain tools to sway one another—and public opinion—during contract negotiations. Advertising and publicity help each side to gain support. When contract negotiations do not run smoothly, unions may apply pressure on management through strikes, slowdowns, or boycotts. Management may counter by imposing lockouts or hiring strikebreakers. Less drastic techniques for breaking contract deadlocks are mediation and arbitration. In both, a neutral third party is involved in the negotiations.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

labor union (18-2)
union-management relations (or labor relations) (18-2)
craft union (18-3)
strike (18-4)
industrial union (18-5)
National Labor Relations Board (NLRB) (18-10)
injunction (18-11)
bargaining unit (18-13)
jurisdiction (18-13)
collective bargaining (18-14)
ratification (18-15)
seniority (18-17)
overtime (18-18)
job security (18-18)
union security (18-18)
closed shop (18-18)
union shop (18-18)
agency shop (18-18)
maintenance shop (18-18)
grievance procedure (18-19)
shop steward (18-19)
arbitration (18-19)
picketing (18-21)
wildcat strike (18-22)
slowdown (18-22)
boycott (18-22)
lockout (18-22)
strikebreaker (18-22)
mediation (18-23)

Discussion Questions

1. Do unions really derive their power mainly from their membership and labor legislation? What are some other sources of union power?
2. How has government regulation of union-management relations evolved during this century?
3. For what reasons do employees start or join unions?
4. List the major areas that are negotiated in a labor contract.
5. Which labor contract issues are likely to be the easiest to resolve? Which are likely to be the most difficult?
6. What is the difference between job security and union security? How do unions attempt to enhance union security?
7. How would you prepare for labor contract negotiations as a member of management? As head of the union negotiating committee?
8. Why are strikes and lockouts relatively rare nowadays?
9. Under what circumstances are strikes and lockouts justified in place of mediation or arbitration?

Case 18

Uber Drivers Steer Toward Unionization

Uber Technologies, Inc., is a technology company offering ride-hailing, food delivery, and other services. Uber is a major player in the gig economy, which is characterized by independent contractors completing short-term contracts. In the case of Uber, drivers decide when and how often they drive, accepting or rejecting ride requests from passengers through the Uber app. Though Uber relies on independent contractors rather than employees, drivers are still organizing to fight for better pay and working conditions.

The employee classification of Uber drivers has been the subject of great debate. According to the National Labor Relations Board (NLRB), Uber drivers are independent contractors rather than employees, but many disagree with that classification. This is a widespread concern because employees receive benefits and protections that independent contractors do not. For example, independent contractors have no right to bargain collectively. Worker classification poses a major threat to gig economy companies that rely on low-cost, flexible labor. If drivers are reclassified as employees, labor costs at these companies would increase. Uber contends that reclassification would mean, in the long run, that it would have to limit the number of drivers or schedule drivers in advance, eliminating the ability for drivers to work as often or as little as they desire.

California legislators passed Assembly Bill 5 in 2019, which classified contract workers for companies such as Uber as employees. The bill expanded the 2018 California Supreme Court decision known as Dynamex. They established a three-point test, often referred to as the ABC test, to determine if a worker is an employee: (1) the company controls the employee's work; (2) the employee's work is a core part of the company's business; and (3) the workers don't typically engage in providing their service to other companies. However, Uber and Lyft successfully lobbied to be exempt from Assembly Bill 5 with Proposition 22 in 2020. Uber garnered support from California voters for the proposition by agreeing to provide added benefits such as paying drivers 120 percent of the state's minimum wage when they are driving a passenger or en route to a pickup. Uber plans to push for similar legislation on a national level.

Even though independent contractors do not have the right to bargain collectively, Uber drivers have banded together to take on the industry. For example, Rideshare Drivers United in Los Angeles, California, is a lobbying group that has organized several strikes to promote better pay and working conditions. In Seattle, Washington, a law allows Uber and Lyft drivers to unionize. A years-long fight over the law came to an end after the city removed provisions that allowed drivers to negotiate pay if they organized. Instead, the Drivers Union, an association for app-based drivers in the area, has backed Seattle Mayor Jenny Durkan's Fare Share plan to improve pay for Uber and Lyft drivers by 30 percent.

Though drivers in New York have been able to unionize since the formation of the Independent Drivers Guild (IDG), a union that Uber helped create in 2016, drivers lack bargaining rights. IDG represents more than 80,000 drivers in New York City alone and advocates for more than 250,000 drivers in New York, New Jersey, Connecticut, and Illinois. A legislative proposal in Connecticut, backed by the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and IDG, aims to compromise with Uber and Lyft by increasing drivers' rights without reclassifying their employment status. This means gig workers could collectively bargain for better pay without being eligible for all of the protections afforded to employees.

Uber faces the same challenges internationally. In the United Kingdom, Uber announced it would reclassify its 70,000 U.K. drivers as employees after it lost a national Supreme Court case. Additionally, hundreds of Uber drivers in Canada have joined the United Food and Commercial Union (UFCW), a labor union that represents 1.3 million people in the United States and Canada. UFCW supports Uber drivers in the fight to address health and safety, pay, and harassment concerns. Shortly after the worker classification ruling in the United Kingdom, Uber introduced proposed changes to Canada's provincial labor laws to give gig workers some benefits without changing their classification. UFCW has decried the tactic as an attempt to circumvent labor laws.

It's clear that Uber's fight is far from over. Uber will continue to defend its business model and attempt to influence regulations as the fight over worker classification continues. Despite these challenges, Uber has become incredibly popular around the world, attracting more than 3.9 million drivers who complete more than 14 million trips each day.[24]

Questions

1. Why is worker classification a threat to the gig economy?
2. How would Uber drivers potentially benefit from unionizing?
3. In your opinion, do you think Uber drivers should be able to unionize and bargain collectively?

Building Skills for Career Success

1. Social Media Exercise

SAG-AFTRA was created from the merger of two labor unions, the Screen Actors Guild and the American Federation of Television and Radio Artists, and today represents 160,000 members around the world. SAG-AFTRA members are actors, singers, dancers, DJs, broadcast journalists and announcers, news writers and editors, puppeteers, and other media professionals. Find SAG-AFTRA's account on Twitter, Instagram, or your favorite social media and examine the content.

1. How is SAG-AFTRA using Twitter or other social media platforms? Using specific tweets or posts, explain your answer.
2. What is the primary audience SAG-AFTRA seems to be targeting with its social media? How could it reach other groups with its social media presence?

2. Building Team Skills

For more than a century, American unions have played an important role in the workplace, striving to improve the working conditions and quality of life of employees. Today, federal laws cover many of the workers' rights that unions first championed. For this reason, some people believe that unions are no longer necessary. However, as technology changes today's workplaces, and the workforce evolves with greater diversity and more part-time, gig, and contract workers, union organizers believe they can increase their memberships and become stronger. What do you think?

Assignment

1. Form a "pro" group and a "con" group and join one of them.
2. Debate whether unions will be stronger or weaker in the next 25 years.
3. Record the key points for each side.
4. Summarize what you learned about unions and their usefulness in a report, and state your position on the debated issue.

3. Researching Different Careers

When applying for a job, whether emailing your résumé directly to a company or through an online job board like Monster, you should always include a cover letter. A well-prepared cover letter should convince the prospective employer to read your résumé and to contact you for an interview. The letter should describe the job you want at that company and your qualifications for the specific job. It should also let the firm know how you prefer to be reached to set up an appointment for an interview.

Assignment

1. Prepare a cover letter to use with a résumé you have prepared. If you have not yet created a résumé, do so now for your dream job. (An example appears in the Online-Only Chapter 17, "Understanding Personal Finances and Investments.")
2. After having several friends review your letter, edit it carefully.
3. Ask your instructor to comment on your letter.

Endnotes

1 Based on information in Jeffrey Dastin and Mike Spector, "Analysis-Amazon's Win in Union Fight Shows Harsh Realities Facing Labor Movement," *Reuters*, April 9, 2021, www.reuters.com/article/us-amazon-com-union-labor-defeat-analysi-idUSKBN2BW2CX; Sebastian Herrera, "Business News: Bezos Says Union's Loss Offers No Comfort—Amazon CEO Thinks Company Needs a Better Vision for Its Employees," *The New York Times*, April 16, 2021, p. B3; Joseph Pisani, "Amazon Faces Biggest Union Push in Its History," *AP News*, March 29, 2021, https://apnews.com/article/amazon-workers-union-c8493c24dabe7609de8fec8716460737; David Streitfeld, "How Amazon Crushes Unions," *The New York Times*, March 16, 2021, www.nytimes.com/2021/03/16/technology/amazon-unions-virginia.html.

2 "Union Membership (Annual) News Release," U.S. Department of Labor, Bureau of Labor Statistics, January 22, 2021, www.bls.gov/news.release/union2.htm (accessed March 15, 2021).

3 "AFL-CIO," Center for Union Facts, https://www.unionfacts.com/union/AFL-CIO (accessed March 15, 2021).

4 "Teamsters," Center for Union Facts, https://www.unionfacts.com/union/Teamsters (accessed March 15, 2021).

5 "Purpose and Power in Community," National Education Association, https://www.nea.org/about-nea (accessed March 15, 2021).

6 "Service Employees International Union," SEIU, https://www.seiu.org/about (accessed March 25, 2021).

7 Connie Lin, "Amazon, Walmart, Target Megastrike: Here's What to Know about the Sprawling Protest," *Fast Company,* April 30, 2020, https://www.fastcompany.com/90499409/amazon-walmart-target-mega-strike-heres-what-to-know-about-the-sprawling-protest (accessed March 15, 2021).

8 Bruce Western and Jake Rosenfeld, "Unions, Norms, and the Rise in U.S. Wage Inequality," *American Sociological Review* 76, 4 (2011): 513–537.

9 "Union-Management Partnership," Yale University, www.yale.edu/bestpractices (accessed March 2, 2015).

10 "Medical Plans: Share of Premiums Paid by Employer and Employee for Family Coverage," U.S. Department of Labor, Bureau of Labor Statistics, News Release, March 2020, https://www.bls.gov/news.release/ebs2.t04.htm (accessed March 26, 2021).

11 "About LMP," Kaiser Permanente Labor Management Partnership, https://www.lmpartnership.org/about-lmp (accessed March 26, 2021).

12 Faiz Siddiqui, "Tesla Engaged in Unfair Labor Practices, Must Reinstate Fired Worker and Scrub Elon Musk Tweet, NLRB Says," *The Washington Post,* March 25, 2021, https://www.washingtonpost.com/technology/2021/03/25/tesla-nlrb-ruling/ (accessed March 26, 2021).

13 “Minimum Wage by State and 2021 Increases,” PayCor, January 4, 2021, https://www.paycor.com/resource-center/articles/minimum-wage-by-state/ (accessed March 26, 2021).

14 “Right to Work States,” National Right to Work, Legal Defense Foundation, http://nrtw.org/rtws.htm (accessed March 26, 2021).

15 “Can I Be Required to Be a Union Member or Pay Dues to a Union?” National Right to Work, Legal Defense Foundation, http://www.nrtw.org/required-join-pay-private (accessed March 26, 2021).

16 Michael Sainato, “FedEx Mounts Big-Money Push to Head Off Unionization by US Workers,” *The Guardian,* January 14, 2020, https://www.theguardian.com/us-news/2020/jan/14/fedex-anti-union-campaign-teamsters (accessed April 1, 2021).

17 Elliott T. Dube, “NLRB Sets Aside Union’s Election Loss for Closure Threat,” *Bloomberg BNA,* June 17, 2016, https://www.bna.com/nlrb-sets-aside-n57982074308/ (accessed March 21, 2017).

18 “General Motors and UAW Reach Tentative Deal to End Month-Long Strike,” *The Guardian,* October 16, 2019, https://www.theguardian.com/business/2019/oct/16/general-motors-uaw-strike-tentative-deal (accessed April 1, 2021).

19 “Work Stoppages Summary,” Bureau of Labor Statistics, U.S. Department of Labor, February 19, 2021, http://www.bls.gov/news. release/wkstp.nrO.htm (accessed April 1, 2021).

20 “Chicago Teachers’ Strike Ends as Union Reaches Labor Deal with the City,” *The Guardian,* October 31, 2019, https://www.theguardian.com/us-news/2019/oct/31/chicago-teachers-strike-ends-union-deal (accessed April 1, 2021).

21 Andrew Khouri, “West Coast Port Slowdown Raises Fear of Dockworker Strike or Lockout,” *Los Angeles Times,* November 10, 2014, http://www.latimes.com/business/la-fi-port-negotiations-20141111-story.html (accessed April 2, 2021); Tiffany Hsu, Andrew Khouri, and Tim Loan, “With Port Talks Gridlocked, White House Move Ramps up Pressure for a Deal,” *Los Angeles Times,* February 14, 2015, http://www.latimes.com/business/la-fi-ports-slowdown-20150215-story.html (accessed April 2, 2021).

22 Anne Jacobson, “Red Wing Shoe and Teamsters Avert Boycott, Reach Contract,” *Duluth News Tribune,* July 23, 2020, https://www.duluthnewstribune.com/business/manufacturing/6587621-Red-Wing-Shoe-and-Teamsters-avert-boycott-reach-contract (accessed April 2, 2021).

23 “Fast Facts About the Agency,” Federal Mediation and Conciliation Service, February 2021, https://www.fmcs.gov/wp-content/uploads/2021/02/FMCS-Fast-Facts-FY2020-update-Feb-2021.pdf (accessed April 2, 2021).

24 Based on information in CityNews Toronto, “Uber Drivers Pushing for Unionization,” *YouTube*, June 26, 2019, www.youtube.com/watch?v=9nz9BDRULf4; Heidi Groover, “Lengthy Legal Fight Over Seattle’s Uber Unionization Law Comes to an End,” *The Seattle Times*, April 13, 2020, www.seattletimes.com/seattle-news/transportation/lengthy-legal-fight-over-seattles-uber-unionization-law-comes-to-an-end; Vanessa Romo, “Uber Drivers Are Not Employees, National Relations Board Rules. Drivers Saw It Coming,” *NPR*, May 15, 2019, www.npr.org/2019/05/15/723768986/uber-drivers-are-not-employees-national-relations-board-rules-drivers-saw-it-com; Josh Eidelson, “Lawmakers Look to Spruce Up Gig Work Rather Than Replace It,” *Bloomberg*, March 18, 2021, www.bloomberg.com/news/articles/2021-03-18/lawmakers-look-to-spruce-up-gig-work-rather-than-replace-it; UFCW Canada, “Uber Canada’s Unilateral Proposal Is ‘a Dangerous Proposition’ Says Uber Workers’ Union,” *GlobeNewswire*, March 11, 2021, www.globenewswire.com/news-release/2021/03/11/2191685/0/en/Uber-Canada-s-unilateral-proposal-is-a-dangerous-proposition-says-Uber-workers-union.html; Andrew J. Hawkins, “Uber Takes a Victory Lap on Prop 22 and Talks about Taking It National,” *The Verge*, November 5, 2020, www.theverge.com/2020/11/5/21551136/uber-prop-22-victory-national-q3-2020-earnings; Uber, “Company Info,” www.uber.com/newsroom/company-info.

APPENDIX A

Careers in Business

Words such as *excited, challenged, scared,* and *frustrated* have been used to describe someone involved in a job search. The reality, however, is that everyone who is employed must have looked for a job at one time or another and survived. Although first-time employees often think that they will work for the same company for their entire career, most people change jobs and even careers during their lifetime. In fact, according to the U.S. Bureau of Labor Statistics, today's job applicants will change jobs more than 12 times in their lifetime. Therefore, the employment information that follows will be of lasting value. Let's begin our discussion with a look at the factors affecting an individual's career choices.

A-1 The Importance of Career Choices

Most people think that career planning begins with an up-to-date résumé and a job interview. In reality, it begins long before you prepare your résumé. It starts with you and what you want to become. In some ways, you have been preparing for a career ever since you started first grade. Everything you have experienced during your lifetime you can now use as a resource to help define your career goals. Let's start with a basic assumption: You will likely spend more time at work than at any other single place during your lifetime. Therefore, it makes sense to spend those hours doing something you enjoy. Unfortunately, some people just work at a *job* because they need money to survive. Other people choose a *career* because there is a commitment not only to a profession but also to their own interests and talents. Whether you are looking for a job or a career, you should examine your priorities. Before reading the next section, you may want to evaluate your priorities by completing the exercise in Figure A-1.

A-1a Personal Factors Influencing Career Choices

Before you choose your career or job, you need to have a pretty good idea of what motivates you and what skills you can offer an employer. The following five questions may help you refine further what you consider important in life:

1. *What types of activities do you enjoy?* Specific interests and activities can help you land a job that will lead to a satisfying career. For example, an interest in coding is beneficial for careers in computer programming, web development, app development, and data science. It may help to list the interests or activities you enjoy, along with those you dislike. Watch for patterns that may influence your career choices.

Figure A-1 Which Priorities Are Important to You?

Priorities Now	Job and Personal Variables	Priorities in Ten years
______	Salary	______
______	Family (children/spouse/parents)	______
______	Personal time	______
______	Job location	______
______	Work-related travel	______
______	Potential for advancement	______
______	Commuting time	______
______	Friendly coworkers/boss	______
______	Job responsibilities	______
______	Personal hobbies	______
______	Prestige	______
______	Benefits	______
______	Vacation time	______
______	Retirement plan	______
______	Security/stability	______
______	Personal growth/fulfillment	______
______	Exposure to new skills	______
______	Other	______

2. *What do you do best?* All jobs in all careers require employees to be able to "do something." It is extremely important to assess what you do best. Be honest with yourself about your ability to succeed in a specific job. It may help to make a list of your strongest job-related skills. Also, try looking at your skills from an employer's perspective. What can you do that an employer would be willing to pay for?
3. *What kind of education will you need?* The type of and amount of education you need is determined by the type of career you choose. For example, certified financial planners (CFPs) must complete coursework through a CFP Board Registered Program and hold a bachelor's degree or higher from an accredited college or university. In some careers, it is impossible to get an entry-level position without a college degree. In other careers, technical or hands-on skills are more important than formal education. Generally, however, more education increases your potential earning power.
4. *Where do you want to live?* When you enter the job market, you may want to move to a different part of the country. According to the U.S. Census Bureau, the Western and Southern regions of the United States are experiencing population increases while the Northeast and Midwest regions are experiencing decreases. These population changes will affect job prospects in each of those areas. Before entering the job market, most people think that they are free to move any place they want. In reality, job applicants may be forced to move to a town, city, or metropolitan area that has jobs available.
5. *Are you willing to work long hours?* In some occupations, you usually work long hours and receive relatively high pay, perhaps due, in part, to the time you spend working. According to data from the U.S. Bureau of Labor Statistics, time-consuming occupations often have average weekly earnings that are higher than those of other occupations.

A-1b Trends in Employment

There have been many changes in employment opportunities in the U.S. labor market. According to the U.S. Bureau of Labor Statistics, employment is projected to grow by 6 million jobs over the next decade. Changes in consumer demand, improvements in technology, and many other factors will contribute to the continually changing employment structure of the U.S. economy. For the latest information, visit the U.S. Bureau of Labor Statistics Office of Occupational Statistics and Employment Projections website at www.bls.gov/emp/.

As you look ahead to your career, you should consider the effects that the trends described below will have on employment and employment opportunities.

- Training, upskilling, and reskilling will become increasingly important as firms require their employees to use the latest technology. Good jobs will require strong educational qualifications.
- Job automation will create new types of jobs. Many of these will be computer-related.
- The workforce is going to become increasingly diverse.
- There will be a greater emphasis on remote work, job sharing, flexible hours, and other innovative work practices to accommodate employees.
- The labor force will continue to age. The median age is projected to be 42.6 years by 2029.
- Healthcare and social assistance are two of the fastest-growing industries.

College graduates with majors in business and management, computer science, education, engineering, and health professions will be in high demand according to human resources experts. There will be fewer manufacturing jobs, and those that remain will require high-tech skills.

A-2 Occupational Search Activities

When most people begin to search for a job, they immediately think of employment websites such as Indeed or LinkedIn. Those websites are an important source of information about jobs, but they are only one source. Many other sources can lead to employment and a satisfying career. As illustrated in Table A-1, there are many important tools for career planning. Therefore, you must be selective in both the type and amount of information you use to guide your job search.

Job hunters have a wealth of knowledge at their fingertips thanks to the internet. You can explore job listings or research companies, industries, or an area of employment that interests you. In addition, the internet allows you to check job listings on employment websites, exchange ideas with other job seekers

Table A-1 Important Tools for Career Planning

Resource	Examples
Experiential research	Internships, volunteering, apprenticeships, assistantships, work-study programs, job shadowing
Career research	Career fairs, university career center, employment agencies, online job boards, networking
Career considerations	Personal interests, required skills, personality fit, educational background
Other resources	Online webinars, personality tests, and other self-assessments

Source: Adapted from Learn.org, “What Are Popular Career Planning Tools?” https://learn.org/articles/What_are_Popular_Career_Planning_Tools.html (accessed April 15, 2021).

through online discussion groups or email, and get career advice from professional counselors. You can also create your own website to inform prospective employers of your qualifications. You may even have a job interview online via Zoom or other videoconferencing software. Most prominent companies use their websites to post job openings and accept applications.

In addition to the internet, the following sources can be of great help when you are trying to find the "perfect job":

1. *Campus career center.* Colleges and universities have career development centers staffed by trained personnel specialists. In most cases, these offices serve as clearing houses for career information. The staff also may be able to guide you in creating your résumé and cover letter and preparing for a job interview with mock interviews.
2. *Professional sources and networks.* A network is a group of people, friends, relatives, and professionals who are in a position to exchange information (including information about job openings) in your field of business. According to many job applicants, networking is one of the best sources of career information and job leads. Start with as many people as you can think of to establish your initial network. Contact these individuals and ask specific questions about job opportunities that they may be aware of. Also, ask each of these individuals to introduce or refer you to someone else who may be able to help you to continue your job search. For networking to work, you must continue this process. Remember that you must follow all leads. Even if you have referrals and introductions, you must still land the job. Finally, remember to thank the people who have helped you.
3. *Private employment agencies.* Private employment agencies charge a fee for helping people find jobs. Typical fees can be as high as 15 to 20 percent of an employee's first-year salary. The fee may be paid by the employer or the employee. As with college career centers, private employment agencies provide career counseling, help to create résumés, and provide preparation for job interviews. Before you use a private employment agency, be sure you understand the terms of any contract or agreement you sign. Above all, make sure that you know who is responsible for paying the agency's fee.
4. *State employment agencies.* Another source of information about job openings in your immediate area is the local office of your state employment agency. Some job applicants are reluctant to use state agencies because the majority of jobs available through these agencies are for semiskilled or unskilled workers.

   From a practical standpoint, it can't hurt to consult state employment agencies. They will have information about some professional and managerial positions available in your area, and you will not be charged a fee if you obtain a job through a state employment agency.

Many people want a job immediately and are discouraged at the thought of an occupational search taking months. The fact is, though, that people seeking entry-level jobs should expect their job search to take three to six months. Job applicants who want higher-paying positions can expect to look for work for as long as a year, eighteen months, or more. Of course, the state of the economy and whether employers are hiring or not can shorten or extend a job search for anyone.

Regardless of how long it takes, most people will tell you that a job search always takes too long. During a job search, you should use the same work habits that effective employees use on the job. When searching for a job, resist the temptation to "take the day off." Instead, make a master list of activities that you want to accomplish each day. If necessary, force yourself to make contacts, do job research, or schedule interviews that might lead to job opportunities. Many job applicants look at the job hunt as their job and work from eight to five, five days a week, until they find the job they want. Above all, realize that an occupational search requires patience and perseverance. And according to many individuals who have been through the process of trying to find a job, perseverance may be the most important trait that successful job hunters need.

A-3 Planning and Preparation

The key to landing the job you want is planning and preparation, and a plan begins with goals. In particular, it is important to determine your *personal goals*, to decide on the role your career will play in reaching those goals, and then to develop your career goals. Once you know where you are going, you can devise a reasonable plan for getting there.

The time to begin planning is as early as possible. You must, of course, satisfy the educational requirements for the occupational area you wish to enter. Early planning will give you the opportunity to do so. But other job seekers will also be fully prepared. Can you do more?

The answer is yes. Corporate recruiters say that the following factors give job candidates a definite advantage:

- *Work experience.* You can get valuable work experience in cooperative work/school programs, during summer vacations, or in part-time jobs during the school year. Experience in your chosen occupational area carries the most weight, but even unrelated work experience is important.
- *The ability to communicate well.* Verbal and written communication skills are increasingly important in all aspects of business. Yours will be tested in your letters to recruiters, résumé, and interviews. You will use these same communication skills throughout your career.
- *Clear and realistic job and career goals.* Recruiters feel most comfortable with candidates who know where they are headed and why they are applying for a specific job.

Again, early planning can make all the difference in defining your goals, sharpening your communication skills (through elective courses, if necessary), and obtaining solid work experience. Refer to Table A-2 to learn about online career planning resources.

Table A-2 **Online Career Planning**

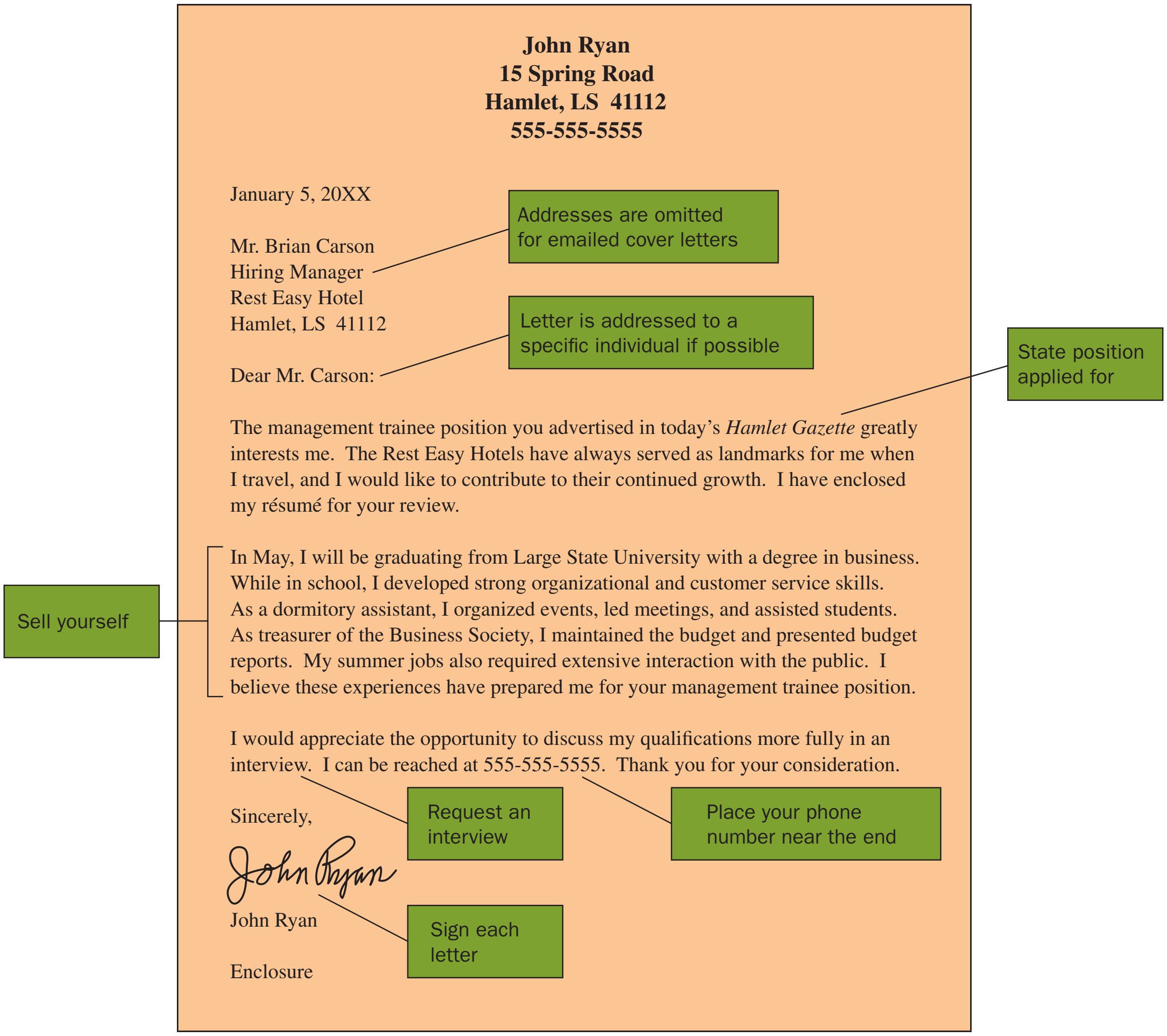
American Marketing Association	www.ama.org
CareerOneStop	www.careeronestop.org
CareerBuilder	www.careerbuilder.com
CollegeGrad	www.collegegrad.com
Glassdoor	www.glassdoor.com
Indeed	www.indeed.com
LinkedIn	www.linkedin.com
LinkUp	www.linkup.com
Monster	www.monster.com
My Perfect Resume	www.myperfectresume.com
Occupational Outlook Handbook	www.bls.gov/ooh
Salary.com	www.salary.com
Vault	www.vault.com

A-3a Cover Letter and Résumé

Preparation is also important when it is time to apply for a position. Your first contact with a prospective employer probably will be through a cover letter in which you express your interest in working for that firm. This letter should be clear and straightforward, and it should follow proper business letter form (refer to Figure A-2). It will be considered part of your employment credentials.

This letter should be addressed to the hiring manager or the human resources manager, by name, if possible. You may include in this letter, very briefly, some information regarding your qualifications and your reason for writing to that particular firm. If your source of information (online job listing, employment agency, a current employee of the firm, and so on) indicates that this employer is looking for specific job skills, you also may want to state and describe in the cover letter the skills you possess. You should request an interview and tell the firm how to reach you. Rather than having one standard cover letter for all job applications, your cover letter should be tailored to each job and company you apply to.

Figure A-2 Sample Cover Letter



John Ryan
15 Spring Road
Hamlet, LS 41112
555-555-5555

January 5, 20XX

Mr. Brian Carson
Hiring Manager
Rest Easy Hotel
Hamlet, LS 41112

Dear Mr. Carson:

The management trainee position you advertised in today's *Hamlet Gazette* greatly interests me. The Rest Easy Hotels have always served as landmarks for me when I travel, and I would like to contribute to their continued growth. I have enclosed my résumé for your review.

In May, I will be graduating from Large State University with a degree in business. While in school, I developed strong organizational and customer service skills. As a dormitory assistant, I organized events, led meetings, and assisted students. As treasurer of the Business Society, I maintained the budget and presented budget reports. My summer jobs also required extensive interaction with the public. I believe these experiences have prepared me for your management trainee position.

I would appreciate the opportunity to discuss my qualifications more fully in an interview. I can be reached at 555-555-5555. Thank you for your consideration.

Sincerely,

John Ryan

John Ryan

Enclosure

Addresses are omitted for emailed cover letters

Letter is addressed to a specific individual if possible

State position applied for

Sell yourself

Request an interview

Place your phone number near the end

Sign each letter

Source: Adapted from U.S. Bureau of Labor Statistics, https://www.bls.gov/careeroutlook/2009/summer/art03.pdf (accessed April 15, 2021).

Generally, a cover letter is submitted along with your résumé. In any case, you should already have prepared the résumé, which is a summary of all your attention-getting employment achievements and capabilities. Your goal in preparing both the cover letter and the résumé is to give the potential employer the impression that you are someone who deserves an interview.

A résumé should highlight and summarize your abilities and work achievements. The résumé should fit on a single page. Most résumés will be submitted digitally, but it is always wise to bring a printed copy on high-quality paper to your interview. Your résumé should be carefully thought-out; rework it as many times as necessary to get it right and put your best foot forward. Make your résumé concise, but be sure to note everything important. Use bullet points to highlight work experience accomplishments, but you need not include too many explanations or details as you will have an opportunity to discuss your qualifications during the interviews. It should be written to grab a potential employer's interest. The employer reading your résumé should want to meet you to find out more. Your résumé needs to show that despite your current job title, you are qualified for the higher-level position you seek.

Remember that you are writing a résumé that will sell you to a potential employer. Discuss the results of projects or work that you produced using action verbs to describe your major contributions. Words such as *managed, created, developed,* and *coordinated* sound high powered. Passive words or phrases such as *was responsible for* and *performed* are not attention-getting. Highlight your work achievements by using percentages, numbers, or dollar amounts. Such concrete details demonstrate just how important your contributions were. In some cases, personal traits or the ability to "do something" may be more important than technical skills. Employers may be looking for someone who can:

1. Prepare letters, memos, and other written communications
2. Answer the telephone and talk with customers
3. Analyze and solve problems related to a specific job
4. Work independently and make decisions
5. Be flexible and get the job done
6. Get along with others and be a team player

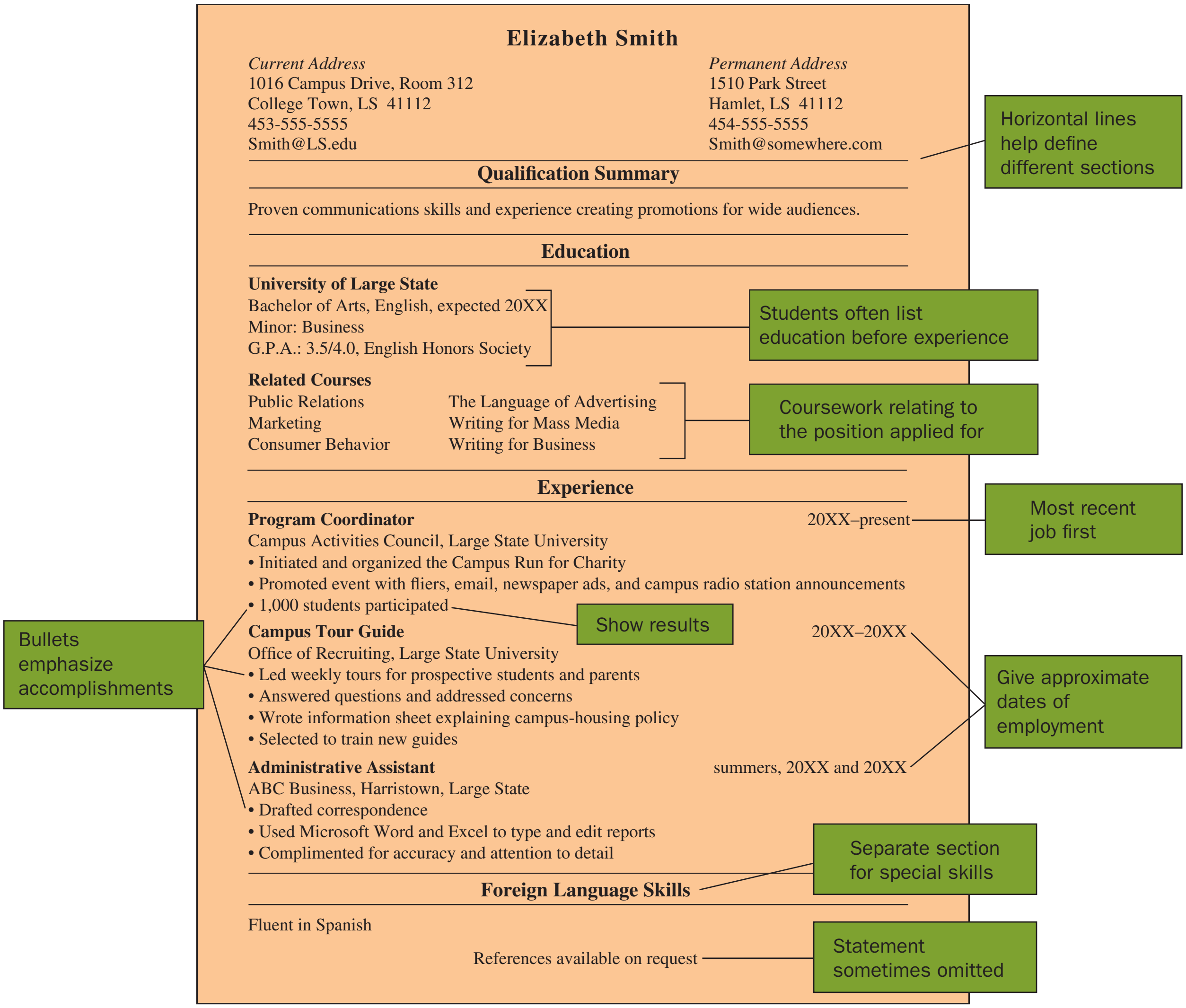
These traits may be extremely important to some employers. And a job applicant who does not have a lot of occupational experience can use these traits to beef up a slim résumé.

Figures A-3 and A-4 show a chronological résumé and a functional résumé, respectively. The chronological résumé presents your education, work experience, and other information in a reverse-time sequence (the most recent item first). The functional résumé emphasizes your abilities and skills in categories such as communication, supervision, project planning, human relations, and research. Regardless of the form used, a résumé should include the following: your name, address, email, and telephone number; your work experience and major accomplishments on the job; your educational background; and any awards you have won. Avoid all extraneous information (e.g., career objectives or the names and addresses of references).

A-3b **Job Application**

Once you have submitted your cover letter and résumé, the next step generally depends on the employer. Many interested prospective employers will ask that you complete an employment application form, complete a job interview, or both. Regardless of what happens next, you should view both the application form and the interview as opportunities to tell the prospective employer about any special skills and talents that make you the type of employee the company is looking for.

Figure A-3 Sample Chronological Résumé



Elizabeth Smith

Current Address
1016 Campus Drive, Room 312
College Town, LS 41112
453-555-5555
Smith@LS.edu

Permanent Address
1510 Park Street
Hamlet, LS 41112
454-555-5555
Smith@somewhere.com

Qualification Summary

Proven communications skills and experience creating promotions for wide audiences.

Education

University of Large State
Bachelor of Arts, English, expected 20XX
Minor: Business
G.P.A.: 3.5/4.0, English Honors Society

Related Courses
Public Relations
Marketing
Consumer Behavior
The Language of Advertising
Writing for Mass Media
Writing for Business

Experience

Program Coordinator 20XX–present
Campus Activities Council, Large State University
- Initiated and organized the Campus Run for Charity
- Promoted event with fliers, email, newspaper ads, and campus radio station announcements
- 1,000 students participated

Campus Tour Guide 20XX–20XX
Office of Recruiting, Large State University
- Led weekly tours for prospective students and parents
- Answered questions and addressed concerns
- Wrote information sheet explaining campus-housing policy
- Selected to train new guides

Administrative Assistant summers, 20XX and 20XX
ABC Business, Harristown, Large State
- Drafted correspondence
- Used Microsoft Word and Excel to type and edit reports
- Complimented for accuracy and attention to detail

Foreign Language Skills

Fluent in Spanish

References available on request

Horizontal lines help define different sections

Students often list education before experience

Coursework relating to the position applied for

Most recent job first

Show results

Bullets emphasize accomplishments

Give approximate dates of employment

Separate section for special skills

Statement sometimes omitted

Source: U.S. Bureau of Labor Statistics, https://www.bls.gov/careeroutlook/2009/summer/art03.pdf (accessed April 15, 2021).

The typical job application form asks for the following information:

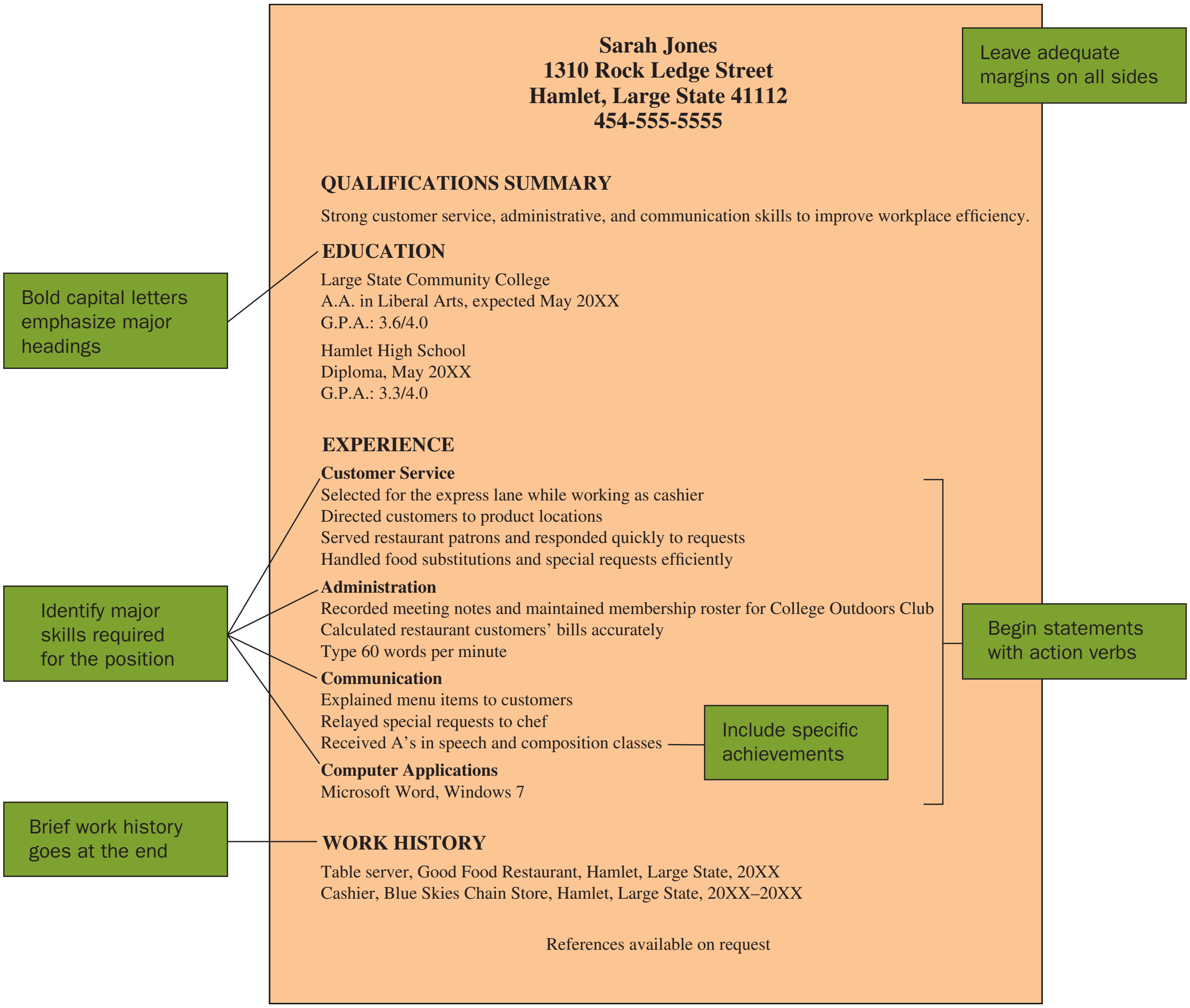
- Personal data
- Educational background
- Military record
- Employment history
- Criminal record
- Character references

Do the best job you can when answering questions in each of these areas. The way you complete an application form demonstrates your ability to follow directions and to communicate effectively. The suggestions listed in Table A-3 can help you avoid some of the most common mistakes applicants make.

A-3c The Job Interview

Your résumé and cover letter are, in essence, an introduction. The deciding factor in the hiring process is the interview (or several interviews) with representatives

Figure A-4 Sample Functional Résumé



Sarah Jones
1310 Rock Ledge Street
Hamlet, Large State 41112
454-555-5555

QUALIFICATIONS SUMMARY

Strong customer service, administrative, and communication skills to improve workplace efficiency.

EDUCATION

Large State Community College
A.A. in Liberal Arts, expected May 20XX
G.P.A.: 3.6/4.0

Hamlet High School
Diploma, May 20XX
G.P.A.: 3.3/4.0

EXPERIENCE

Customer Service
Selected for the express lane while working as cashier
Directed customers to product locations
Served restaurant patrons and responded quickly to requests
Handled food substitutions and special requests efficiently

Administration
Recorded meeting notes and maintained membership roster for College Outdoors Club
Calculated restaurant customers' bills accurately
Type 60 words per minute

Communication
Explained menu items to customers
Relayed special requests to chef
Received A's in speech and composition classes

Computer Applications
Microsoft Word, Windows 7

WORK HISTORY

Table server, Good Food Restaurant, Hamlet, Large State, 20XX
Cashier, Blue Skies Chain Store, Hamlet, Large State, 20XX–20XX

References available on request

Leave adequate margins on all sides

Bold capital letters emphasize major headings

Identify major skills required for the position

Begin statements with action verbs

Include specific achievements

Brief work history goes at the end

Source: Adapted from U.S. Bureau of Labor Statistics, https://www.bls.gov/careeroutlook/2009/summer/art03.pdf (accessed April 15, 2021).

Table A-3 Tips for Completing Employment Application Forms

1. Most applications are completed online, but if it is not possible to apply online, complete the application in ink, print clearly, use one lettering style, and be neat.
2. Thoroughly read and follow the directions on the employment application.
3. Read all questions before you begin answering them.
4. Fill in every blank even if you must write not applicable (N/A) or none.
5. Use only recognizable abbreviations.
6. Include your entire work history.
7. Answer all questions honestly.
8. Ask for professional references before including their contact information on an application.
9. Be careful when writing salary requirements. Avoid committing yourself to a specific number and know the going rate in your field.
10. Be prepared to explain gaps in your job history.
11. Read over the completed application and look for grammatical or spelling errors.
12. Ask a friend, family member, or coworker to proofread your application to get an outsider's perspective.

of the firm. It is through the interview that the firm gets to know you and your qualifications. At the same time, the interview provides a chance for you to learn about the firm.

Here, again, preparation is the key to success. Research the firm before your first interview. Learn all you can about its products, its subsidiaries, the markets it operates in, its history, the locations of its facilities, and so on. If possible, obtain and read the firm's most recent annual report. Be prepared to ask questions about the firm and the opportunities it offers. Interviewers welcome such questions. They expect you to be interested enough to spend some time thinking about your potential relationship with their firm.

Prepare also to respond to questions the interviewer may ask. Table A-4 is a list of typical interview questions that job applicants often find difficult to answer. However, do not expect interviewers to stick to the list given in the table or to the items appearing in your résumé. They will be interested in anything that helps them decide what kind of person and worker you are.

Make sure that you are on time for your interview and are professionally dressed. Interviewers take note of punctuality and appearance, just as they do of other personal qualities. Have a copy of your résumé with you, even if you have already sent one to the firm. You also may want to bring letters of recommendation. If you plan to furnish interviewers with the names and contact information of references rather than letters of recommendation, make sure that you have your references' permission to do so.

Consider the interview itself as a two-way conversation rather than as a question-and-answer session. Volunteer any information that is relevant to the interviewer's questions. If an important point is skipped in the discussion, do not hesitate to bring it up. Be yourself, but don't hesitate to emphasize your strengths. Good eye contact

Table A-4 Interview Questions Job Applicants Often Find Difficult to Answer

1. Tell me about yourself.
2. What do you know about our organization?
3. What can you do for us? Why should we hire you?
4. What qualifications do you have that make you feel that you will be successful in our field?
5. What have you learned from the jobs that you have held?
6. What is your dream job?
7. What are your special skills, and how did you acquire them?
8. Have you had any special accomplishments in your lifetime that you are particularly proud of?
9. Why did you leave your most recent job?
10. How do you spend your spare time? What are your hobbies?
11. What are your strengths and weaknesses?
12. Discuss five major accomplishments.
13. What kind of boss would you like? Why?
14. If you could spend a day with someone you have known or known of, who would it be?
15. What personality traits do you dislike?
16. How do you show your anger? What types of things make you angry?
17. With what type of person do you spend the majority of your time?
18. What activities have you ever quit?
19. Define cooperation.

and posture are important, too. They should come naturally if you take an active part in the interview.

At the conclusion of the interview, thank the recruiter for taking the time to see you. Then, a day or two later, follow up by sending a short letter or email of thanks. If you write a physical letter, consider hand-delivering it to ensure it is delivered promptly. In this letter, you can ask a question or two that may have occurred to you after the interview or add pertinent information that may have been overlooked.

In most cases, the first interview is used to *screen* applicants, or to choose those who are best qualified. These applicants are then given a second interview and perhaps a third, usually with one or more department heads. If the job requires relocation to a different area, applicants may be invited there for these later interviews. After the interviewing process is complete, applicants are told when to expect a hiring decision.

A-3d **Accepting an Offer**

"We'd like to offer you the job" may be the best news a job applicant can hear. Job offers are often delivered by phone, via email, or in person. To accept the job, you should send the firm an acceptance letter, most likely via email, in which you express your appreciation, accept the offer, and restate the conditions of employment as you understand them. These conditions should include the starting salary, employee benefits, and a general description of the job (responsibilities, training, the immediate supervisor's name, and such). If you have any concerns regarding the job, make sure that they are cleared up before you send your letter of acceptance: The job offer and your acceptance constitute a contract between you and the firm.

Less exciting is the news that begins, "We thank you for your interest in our firm, *but*...." The fact is that there are many more applicants than there are jobs. This is so because most people apply for several positions at the same time. As a result, most people are turned down for some jobs during their careers. Do not be discouraged if you don't get the first position you apply for. Instead, think back over the application process, analyze it, and try to determine what you might improve. In other words, learn from your experience, and keep trying. Success will come if you persevere.

A-4 **A Final Note About Careers**

A job is for today, but a career can last a lifetime. Although most applicants are excited when they get their first job, the employment process does not stop with your first job, it continues throughout your career. Additional training and education, promotions and advancement, and even changing jobs or careers are all part of a continuing process.

Although different people measure success in different ways, success in a career means more than just knowing how to do a job. You must combine technical skills and managerial skills with the ability to get along with people. Generally, people who are promoted know how to make decisions, communicate well, and handle stress. These same people also can manage another valuable asset, their time.

In any career, there will be times when you need to reevaluate your decisions and opportunities. It may be necessary to determine what you can do to get your career back on track. It may even be necessary to change jobs or careers to obtain a better or more rewarding position. Although there are no guarantees, workers who can adapt to change and who are willing to pursue further education and training are more likely to be successful. The world is changing, and it is your responsibility to make the right decisions. Your teachers, friends, and relatives are willing to help you to make decisions, but it is your life and you must take charge. Good luck!

Summary

Many people work at a job because they need money to survive. A career, on the other hand, is a commitment not only to a profession but also to an individual's own interests and talents. Before choosing a career, you must evaluate what you like to do, what you are good at, how much education you need, and where you want to live. Also, are you willing to work long hours?

Individuals should also consider future trends in employment before deciding on a career. It is expected that there will be an increased emphasis on training, upskilling, reskilling, and automation, and that job seekers must incorporate each of these trends into their career plans. Additionally, the workforce is becoming increasingly diverse. Furthermore, there will be a greater emphasis on remote work, job sharing, flexible hours, and other innovative work practices.

When job applicants begin their career search, they usually obtain information from many sources such as employment websites, campus career centers, a network of friends and professionals, and employment agencies. Employment agencies may be divided into two categories: private and state. Both types help individuals obtain jobs, but private employment agencies do charge a fee for their services. Although most people want a job immediately, an occupational job search takes time. During the occupational job search, you should use the same effective work habits that employees use on the job. Above all, you should realize that an occupational search requires patience and perseverance.

The time to begin career planning is as early as possible. According to corporate recruiters, work experience, the ability to communicate well, and realistic job and career goals are essential. Preparation again becomes important when it is time to apply for a position. You should develop both your résumé and cover letter very carefully. Your goal in preparing both is to give the potential employer the impression that you are someone who deserves an interview.

Once you have submitted your cover letter and résumé, the next step generally depends on the employer. If interested, many prospective employers will ask you to complete an employment application. Although employment applications vary in form and length, the typical application asks for the following information: personal data; military record; criminal record; educational background; employment history; and character references. You should always view the application as an opportunity to tell the prospective employer about your special skills and talents. Above all, completing an application allows you to demonstrate your ability to follow directions and to communicate effectively.

Your cover letter, résumé, and application are, in essence, an introduction. The deciding factor in the hiring process is the interview with representatives of the firm. Once again, preparation is the key. Learn as much as you can about the firm and the opportunities it offers. Also, prepare to answer questions that the interviewer may ask. In most cases, the first interview is used to screen applicants, or choose those that are the best qualified. These applicants are then given a second, and perhaps a third, interview—usually with one or more department heads. If a job is offered, you should send the firm an acceptance letter, most likely via email, expressing your appreciation, accepting the offer, and restating the conditions of employment as you understand them.

To be competitive in today's world, you must realize that career planning doesn't stop when you get your first job. Additional training and education, promotions and advancements, and even changing jobs or careers are all part of a continuing process. In any career, there will be times when you need to reevaluate your decisions and opportunities. The world is changing, and workers who can adapt to change and who are willing to pursue further education and training are most likely to be successful.

APPENDIX B

Risk Management and Insurance

We begin this appendix by defining two broad categories of risk: pure risk and speculative risk. We then examine several methods of risk management available to individuals and businesses and consider situations in which each method is appropriate. Next, we turn our attention to insurance companies—organizations that, for a fee, assume financial responsibility for losses resulting from certain kinds of risks. We see how insurance companies determine which risks they will cover and what prices they will charge for coverage. Then we list the major types of insurance against loss of property and loss due to accidents and discuss workers' compensation and healthcare insurance. Finally, we close the appendix with a comparison of several kinds of life insurance.

B-1 The Element of Risk

Risk is the possibility that a loss or injury will occur. It is impossible to escape all types of risk in today's world. For individuals, driving an automobile, investing in stocks or bonds, and even jogging along a country road are situations that involve some risk. For businesses, risk is a part of every decision. In fact, the essence of business decision making is weighing the potential risks and gains involved in various courses of action.

There is obviously a difference between, say, the risk of losing money you have invested and the risk of being hit by a car while jogging. This difference leads to the classification of risks as either speculative or pure risks.

A **speculative risk** is the possibility of loss or harm that accompanies the potential of earning a profit. Most business decisions, such as the decision to market a new product, involve speculative risks. If the new product succeeds in the marketplace, there are profits; if it fails, there are losses. As an example, PepsiCo repeatedly gambles when it introduces new beverage and food products to compete with its rival Coca-Cola. But the gamble does not pay off if the product fizzles and the company loses the millions of dollars it invested in product development.

A **pure risk** is a possibility of loss or harm that involves only the threat of loss, with no potential for gain. The possibility of damage due to hurricane, fire, or automobile accident is a pure risk because there is no gain if such damage does not occur. Another pure risk is the risk of large medical bills resulting from a serious illness. Again, if there is no illness, there is no monetary gain.

Let us now look at the various techniques available for managing risk.

risk the possibility that a loss or injury will occur

speculative risk the possibility of loss or harm that accompanies the potential of earning a profit

pure risk a possibility of loss or harm that involves only the threat of loss, with no potential for gain

risk management the process of evaluating the possible threats faced by a firm or an individual and then minimizing the costs involved should those threats actually come to pass

B-2 Risk Management

Risk management is the process of evaluating the possible threats faced by a firm or an individual and then minimizing the costs involved should those threats actually come to pass. Any risk entails two types of costs. The first is the cost that will be incurred if a potential loss becomes an actual loss. An example is the cost of rebuilding and reequipping an assembly plant that burns to the ground. The second type consists of the costs of reducing or eliminating the risk of potential loss. Here we would include the cost of purchasing insurance against loss by fire or the cost of not building the plant at all (this cost is equal to the profit that the plant might have earned). These two types of costs must be balanced, one against the other, if risk management is to be effective.

Most people think of risk management as simply buying insurance. However, although insurance is an important part of risk management, it is not the only means of dealing with risk. Other methods may be less costly in specific situations. And some kinds of risks are uninsurable—not even an insurance company will issue a policy to protect against them. In this section, we examine the four risk-management techniques. Then, in the following sections, we look more closely at insurance.

B-2a **Risk Avoidance**

An individual can avoid the risk of an automobile accident by not riding in a car. A manufacturer can avoid the risk of product failure by refusing to introduce new products. Both would be practicing risk avoidance—but at a very high cost. People who strive to avoid automobile accidents by forgoing cars may have to give up their jobs to do so. A business that does not take a chance on new products probably will fail when the product life cycle, discussed in Chapter 12, catches up with its existing products.

There are, however, situations in which risk avoidance is a practical technique. At the personal level, individuals who stop smoking or refuse to walk through a dark city park late at night are avoiding risks. Jewelry stores lock their merchandise in vaults at the end of the business day to avoid losses through robbery. And to avoid the risk of a holdup, many gasoline stations accept only credit cards or the exact amount of the purchase for sales made after dark.

Obviously, no person or business can eliminate all risks. By the same token, however, no one should assume that all risks are unavoidable.

B-2b **Risk Reduction**

If a risk cannot be avoided, perhaps it can be reduced. An automobile passenger can reduce the risk of injury in an automobile accident by wearing a seat belt (and can also reduce the risk of getting a ticket by doing so). A manufacturer can lessen the risk of product failure through careful product planning and market testing. In both situations, the cost of reducing risk seems to be well worth the potential savings.

Businesses face risks as a result of their operating procedures and management decision making. An analysis of operating procedures—by company personnel or outside consultants—often can identify areas in which risk can be reduced. Among the techniques that can be used are:

- The establishment of an employee safety program to encourage employees' awareness of safety;
- The purchase *and* use of proper safety equipment, from hand guards on machinery to goggles and safety shoes for individuals;
- Burglar alarms, security guards, and even guard dogs to protect facilities from burglary;
- Fire alarms, smoke alarms, and sprinkler systems to reduce the risk of fire and the losses due to fire; and
- Accurate and effective accounting and financial controls to protect a firm's inventories and cash from pilfering.

The risks involved in management decisions can be reduced only through effective decision making. These risks increase when a decision is made hastily or is based on less than sufficient information. However, the cost of mitigating these risks goes up when managers take too long to make decisions. Costs also increase when managers require an overabundance of information before they are willing to decide.

B-2c **Risk Assumption**

An individual or organization will—and probably must—take on certain risks as part of living or doing business. Individuals who drive to work assume the risk of having an accident, but they wear a seat belt to reduce the risk of injury in the event of an accident. The firm that markets a new product assumes the risk of product failure—after first reducing that risk through market testing.

Risk assumption, then, is the act of taking responsibility for the potential loss or injury that may result from a risk. Generally, it makes sense to assume a risk when one or more of the following conditions exist:

- The potential loss is too small to worry about;
- Effective risk management has reduced the risk;
- Insurance coverage, if available, is too expensive; or
- There is no other way of protecting against the loss.

Large firms with many facilities often find a particular kind of risk assumption, called self-insurance, a practical way to avoid high insurance costs. **Self-insurance** is the process of establishing a monetary fund that can be used to cover the cost of a loss. For instance, suppose that a company has approximately 16,000 ABC convenience stores, each worth an average of $400,000, scattered around the country. A logical approach to self-insurance against fire losses would be to collect a certain sum—say, $600—from each store every year. The company places these funds in an interest-bearing reserve fund and uses them as necessary to repair any fire damage that occurs to ABC stores. Money not used remains the property of the firm. Eventually, if the fund grows, the yearly contribution from each store can be reduced.

Self-insurance does not eliminate risks; it merely provides a means for covering losses. And it is, itself, a risky practice—at least in the beginning. For example, ABC would suffer a considerable financial loss if more than 24 stores were destroyed by fire in the first year the self-insurance program was in effect.

B-2d **Shifting Risks**

Perhaps the most common method of dealing with risk is to shift, or transfer, the risk to an insurance company. An **insurer (**or **insurance company)** is a firm that agrees, for a fee, to assume financial responsibility for losses that may result from a specific risk. The fee charged by an insurance company is called a **premium**. A contract between an insurer and the person or firm whose risk is assumed is known as an **insurance policy**. Generally, an insurance policy is written for a period of one year. Then, if both parties are willing, it is renewed each year. It specifies exactly which risks are covered by the agreement, the dollar amounts the insurer will pay in case of a loss, and the amount of the premium.

Insurance is thus the protection against loss that the purchase of an insurance policy affords. Insurance companies will not, however, assume every kind of risk. A risk that insurance companies will assume is called an insurable risk. **Insurable risks** include the risk of loss by fire and theft, the risk of loss by automobile accident, and the risk of sickness and death. A risk that insurance companies will not assume is called an **uninsurable risk**.

In general, pure risks are insurable, whereas speculative risks are uninsurable (refer to Figure B-1). An insurance company may agree, for example, to protect a

self-insurance the process of establishing a monetary fund that can be used to cover the cost of a loss

insurer (or **insurance company)** a firm that agrees, for a fee, to assume financial responsibility for losses that may result from a specific risk

premium the fee charged by an insurance company

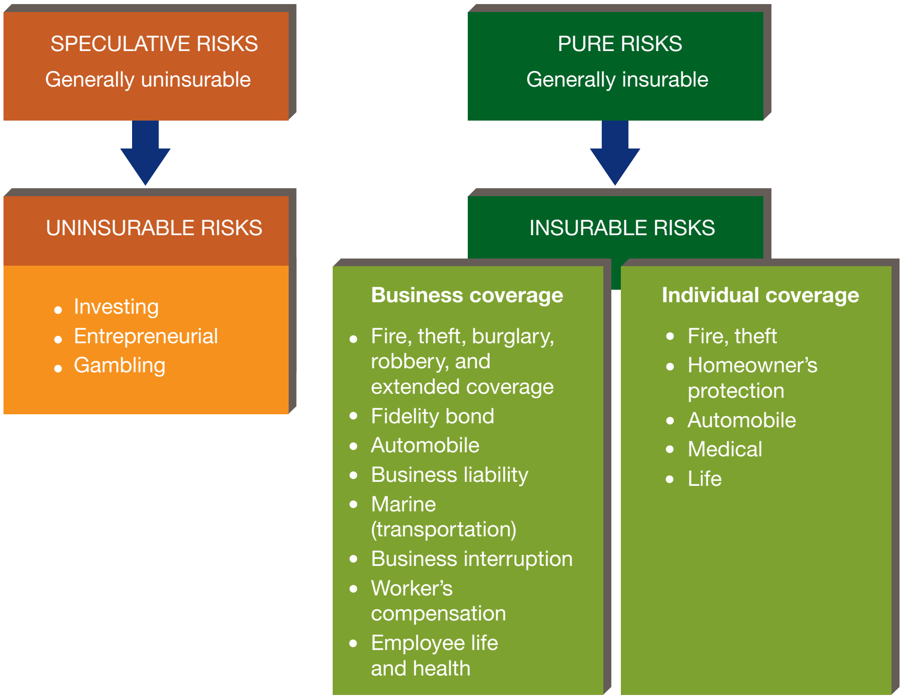
insurance policy the contract between an insurer and the person or firm whose risk is assumed

insurance the protection against loss that the purchase of an insurance policy affords

insurable risk a risk that insurance companies will assume

uninsurable risk a risk that insurance companies will not assume

Figure B-1 Insurable and Uninsurable Risk for Businesses and Individuals


SPECULATIVE RISKS
Generally uninsurable
PURE RISKS
Generally insurable
UNINSURABLE RISKS
Investing
Entrepreneurial
Gambling
INSURABLE RISKS
Business coverage
Fire, theft, burglary, robbery, and extended coverage
Fidelity bond
Automobile
Business liability
Marine (transportation)
Business interruption
Worker's compensation
Employee life and health
Individual coverage
Fire, theft
Homeowner's protection
Automobile
Medical
Life

Ford Motor Company assembly plant against losses due to fire or tornadoes. It will not agree, however, to protect Ford against losses resulting from a lack of sales orders for automobiles.

The next section provides an overview of the basic principles of insurance and the kinds of companies that provide insurance.

B-3 Insurance and Insurance Companies

An insurance company is a business. Like other businesses, an insurer provides a product—protection from loss—in return for a reasonable fee. Its sales revenues are the premiums it collects from the individuals and firms it insures. (Insurance companies typically invest the money they have on hand; thus we should include interest and dividend income as part of their revenues.) Its expenses are the costs of the various resources—salaries, rent, utilities, and so on—plus the amounts the insurance company pays out to cover its clients' losses.

Generally, an insurance company expects to earn more from premiums than it pays out to cover customers' insured losses. In some years, though, it may suffer losses when payouts for claims exceed revenues from premiums. Consider the record-breaking Western wildfire season of 2020, which had 69 major fires that burned more than 1,000 acres each. In California alone, five wildfires caused more than 30 deaths, destroyed 8,500 structures, and burned more than 4.4 million acres. Colorado, Washington, and Oregon also experienced many serious fires. These fires required that insurers pay out \$7 billion to \$13 billion to cover insured losses for property damage, business interruptions, evacuations, and the living expenses incurred by those who had to evacuate or rebuild. To compensate for the huge payouts, insurance companies are raising fire insurance premiums in these states and, in some areas, have stopped providing coverage altogether.[1] In recent years, mega-catastrophes have occurred worldwide, resulting from hurricanes and cyclones, earthquakes, floods, droughts, and of course the COVID-19 pandemic. These were expected to cost insurance companies more than $80 billion in 2020 alone.[2]

Pricing and product are very important and exacting issues to an insurance company primarily because it must set its price (its premiums) before knowing the specific cost of its product (the amount of money it will have to pay out in claims). For this reason, insurance companies employ mathematicians called actuaries to predict the likelihood of losses and to determine the premiums that should be charged. Increasingly, they utilize sophisticated software and artificial intelligence to analyze risk. Let us look at some of the more important concepts on which insurance (and the work of actuaries) is based.

B-3a **Basic Insurance Concepts**

Insurance is based on several principles, including the principle of indemnity, insurability of the risk, and low-cost coverage.

The Principle of Indemnity The purpose of insurance is to provide protection against loss; it is neither speculation nor gambling. This concept is in the **principle of indemnity**: In the event of a loss, an insured firm or individual cannot collect from the insurer an amount greater than the actual dollar amount of the loss. Suppose that you own a home valued at $250,000. You decide to purchase $300,000 worth of fire insurance on your home. However, even if it is destroyed by fire, the most the insurer will pay you is $250,000, the actual amount of your loss.

The premiums set by actuaries are based on the amount of risk involved and the amount to be paid in case of a loss. Generally, the greater the risk and the amount to be paid, the higher is the premium.

Insurability of the Risk Insurers will accept responsibility for risks that meet at least the following conditions:

1. *Losses must not be under the control of the insured.* Losses caused by fire, wind, or accident generally are insurable, but gambling losses are not. Nor will an insurer pay a claim for damage intentionally caused by the insured person. For example, a person who sets fire to an insured building cannot collect on a fire insurance policy.
2. *The insured hazard must be geographically widespread.* That is, the insurance company must be able to write many policies covering the same specific hazard throughout a wide geographic area. This condition allows the insurer to minimize its own risk: The risk that it will have to pay huge sums of money to clients within a particular geographic area in the event of a catastrophe caused, for example, by a tornado or an earthquake.
3. *The probability of a loss should be predictable.* Insurance companies cannot tell which particular clients will suffer losses. However, their actuaries must be able to determine, statistically, what fraction of their clients will suffer each type of loss. They can do so, for insurable risks, by examining records of losses for past years. They can then base their premiums, at least in part, on the number and value of the losses that are expected to occur.
4. *Losses must be measurable.* Insured property must have a value that is measurable in dollars because insurance firms reimburse losses with money. Moreover, premiums are based partly on the measured value of the insured property. As a result of this condition, insurers will not insure an item for its emotional or sentimental value but only for its actual monetary value.
5. *The policyholder must have an insurable interest.* That is, the individual or firm that purchases an insurance policy must be the one that would suffer

principle of indemnity in the event of a loss, an insured firm or individual cannot collect from the insurer an amount greater than the actual dollar amount of the loss from a loss. You can purchase insurance on your own home, but you cannot insure your neighbor's home in the hope of making a profit if it should burn down! Generally, individuals are considered to have an insurable interest in their family members. Therefore, a person can insure the life of a spouse, a child, or a parent. Corporations may purchase "key executive" insurance covering certain corporate officers. The proceeds from this insurance help offset the loss of the services of these key people if they die or become incapacitated.

Low-Cost Coverage Price is usually a marketing issue rather than a technical concept. However, the price of insurance is inherently tied to the risks and potential losses involved in a particular type of coverage. Insurers would like to "produce" insurance at a very low cost to their policyholders, but they must charge enough in premiums to cover their expected payouts.

Customers purchase insurance when they believe premiums are low in relation to the possible dollar loss. For certain risks, premiums can soar so high that insurance is simply not cost-effective. A $1,000 life insurance policy for a 99-year-old man would cost about $950 per year. Clearly, a man of that age would be better off if he invested the premium amount in a bank. He would thus be using self-insurance rather than shifting the risk. Although this is an extreme example, it illustrates that insurers must compete, through their prices, with alternative methods of managing risk.

B-3b Ownership of Insurance Companies

Insurance companies are owned either by stockholders or by policyholders. A **stock insurance company** is owned by stockholders and is operated to earn a profit. Like other profit-making corporations, stock insurance companies pay dividends to stockholders from surplus of income (left over after benefit payments, operating expenses, and taxes have been paid). Most of the approximately 6,000 insurance companies in the United States are stock insurance companies, including GEICO and Allstate.

A **mutual insurance company** is owned collectively by its policyholders and is thus a cooperative. Because a mutual insurance company has no stockholders, its policyholders elect the board of directors. The members of the board, in turn, choose the executives who manage the firm. Any surplus of income over expenses is distributed to policyholders as a return of part of their premiums. (This return may take the form of a reduced premium at the start of the policy year or of a "dividend" at the end of the policy year.) Mutual insurance companies often have the word "mutual" as part of their name, like Liberty Mutual.

Both stock and mutual insurance companies must maintain cash reserves to cover future obligations and policyholders' claims. They typically invest these cash reserves in certificates of deposit, stocks, bonds, and real estate.

B-3c Careers in Insurance

Insurance companies form one of the largest industries in the United States. The industry ranks in importance with banking and finance, manufacturing, building, and electronics. Careers in insurance generally fall into two categories: sales and administration.

In the sales category, individuals can work as employees of insurance companies or as independent agents representing more than one insurance company. Recently, the insurance industry has placed more emphasis on advanced training for sales personnel. Life insurance salespeople who pass examinations and meet other requirements are awarded the Chartered Life Underwriter (CLU) designation. The Chartered Property Casualty Underwriter (CPCU) designation is awarded to individuals who pass examinations and meet the requirements in all areas except life insurance.

stock insurance company an insurance company owned by stockholders and operated to earn a profit

mutual insurance company an insurance company that is owned collectively by its policyholders and is thus a cooperative

Administrative employees work to meet the needs of the firm's customers. They must process policies and claims and handle an amazing amount of paperwork. Jobs in this category include actuary, claims adjuster, claims clerk, underwriter, and a number of other essential positions. In addition to meeting the needs of customers, administrative employees are responsible for investing funds for an insurance company.

B-4 Property and Casualty Insurance

Businesses and individuals insure their property, such as buildings, against losses and purchase casualty insurance to cover financial losses resulting from injuries or damage caused by accidents.

Insurance is available to cover most pure risks, but specialized or customized policies can be expensive. A part of effective risk management is to ensure that when insurance is purchased, the coverage is appropriate for the situation. Three questions can be used as guidelines in this regard:

- What hazards must be insured against?
- Is the cost of insurance coverage reasonable in this situation?
- What other risk-management techniques can be used to reduce insurance costs?

B-4a Fire Insurance

Fire insurance covers losses due to fire. The standard fire insurance policy provides protection against partial or complete loss of a building and/or its contents when that loss is caused by fire or lightning. The cost of premiums depends on the construction of the building, its use and contents, whether risk-reduction devices (such as smoke and fire alarms) are installed in the building, and other factors. If a fire occurs, the insurance company reimburses the policyholder for either the actual dollar loss or the maximum amount stated in the policy, whichever is lower.

Coinsurance Clause To reduce their insurance premiums, individuals and businesses sometimes choose to insure property for less than its actual cash value. Their theory is that fire rarely destroys a building completely—thus they need not buy full insurance. However, if the building is partially destroyed by fire, they expect their insurer to cover all the damage. This places an unfair burden on the insurance company, which receives less than the full premium but must cover the full loss. To avoid this problem, most fire insurance policies include a coinsurance clause.

A **coinsurance clause** is a part of a fire insurance policy that requires the policyholder to purchase coverage at least equal to a specified percentage of the replacement cost of the property in order to obtain full reimbursement for losses. In most cases, the requirement is 80 percent of the replacement cost. Suppose that the owners of a $600,000 building decide to purchase only $300,000 worth of fire insurance. If the building is totally destroyed, the insurance company must pay the policy's face value of $300,000. However, if the building is only partially destroyed, and the damage amounts to $200,000, the insurance company will pay only $125,000. This dollar amount is calculated in the following manner:

1. The coinsurance clause requires coverage of at least 80 percent of $600,000, or $480,000.
2. The owners have purchased only $300,000 of insurance. Thus they have insured themselves for only a portion of any loss. That portion is $300,000 ÷ $480,000 = 0.625, or 62.5 percent.
3. The insurance company therefore will reimburse the owner for only 62.5 percent of any loss. In the case of a $200,000 loss, the insurance company will pay 62.5 percent of $200,000, or $125,000.

fire insurance insurance that covers losses due to fire

coinsurance clause a part of a fire insurance policy that requires the policyholder to purchase coverage at least equal to a specified percentage of the replacement cost of the property to obtain full reimbursement for losses

If the owners of the building had insured it for at least $480,000, the insurance company would have covered the entire $200,000 loss.

Extended Coverage **Extended coverage** is insurance protection against damage caused by wind, hail, explosion, vandalism, riots or civil commotion, falling aircraft, and smoke. Extended coverage is available as an endorsement, or addition, to some other insurance policy—usually a fire insurance policy. The premium for extended coverage is generally quite low (much lower than the total cost of separate policies covering each individual hazard). Normally, losses caused by war, nuclear radiation or contamination, and water (other than in storms and floods) are excluded from extended-coverage endorsements.

B-4b Burglary, Robbery, and Theft Insurance

Burglary is the illegal taking of property through forcible entry. A kicked-in door, a broken window pane, or pry marks on a windowsill are evidence of a burglary or attempted burglary. *Robbery* is the unlawful taking of property from an individual by force or threat of violence. A thief who uses a gun to rob a gas station is committing robbery. Theft (or larceny) is a general term that means the wrongful taking of property that belongs to another. Insurance policies are available to cover burglary only, robbery only, theft only, or all three. Premiums vary with the type and value of the property covered by the policy.

Business owners also must be concerned about crimes that employees may commit. A **fidelity bond** is an insurance policy that protects a business from theft, forgery, or embezzlement by its employees. If such a crime does occur, the insurance company reimburses the business for financial losses up to the dollar amount specified in the policy. Individual employees or specific positions within an organization may be bonded. It is also possible to purchase a "blanket" policy that covers the entire work force. Fidelity bonds are purchased most commonly by banks, savings and loan associations, finance companies, and other firms whose employees handle cash on a regular basis.

Although business owners are concerned about shoplifting, they often find that insurance coverage, if available, is too expensive. And it is often difficult to collect on losses resulting from shoplifting because such losses are difficult to prove.

B-4c Motor Vehicle Insurance

Individuals and businesses purchase automobile insurance because it is required by state law, because it is required by the firm financing the purchase of the vehicle, and/or because they want to protect their investment. Most types of automobile coverage can be broadly classified as either liability or physical damage insurance. Table B-1 shows the distinction.

Automobile Liability Insurance **Automobile liability insurance** covers financial losses resulting from injuries or damage caused by the insured vehicle.

Table B-1 **Automobile Insurance Coverage**

Liability insurance covers financial losses resulting from injuries or damage caused by the insured vehicle; physical damage insurance covers damage to the insured vehicle.

Liability Insurance	Physical Damage Insurance
Bodily injury	Collision
Property damage	Comprehensive
Medical payments	Uninsured motorists

extended coverage insurance protection against damage caused by wind, hail, explosion, vandalism, riots or civil commotion, falling aircraft, and smoke

fidelity bond an insurance policy that protects a business from theft, forgery, or embezzlement by its employees

automobile liability insurance insurance that covers financial losses resulting from injuries or damage caused by the insured vehicle

Most automobile policies have a liability limit that contains three numbers. For example, the liability limits stated on a policy might be 100/300/50. The first two numbers indicate the maximum amounts, in thousands of dollars, the insurance company will pay for bodily injury. *Bodily injury liability coverage* pays medical bills and other costs in the event that an injury or death results from an automobile accident in which the policyholder is at fault. Bodily injury liability coverage protects the person in the other car and usually is specified as a pair of dollar amounts. In the preceding example, the policy limits are $100,000 for each person and $300,000 for each occurrence. This means that the insurance company will pay up to $100,000 to each person injured in an accident and up to a total of $300,000 to all those injured in a single accident. Coverage limits can be as low as the state requires and as high as $500,000 per person and $1 million per accident. Payment for additional damage above the policy limits is the responsibility of the insured. In view of the cost of medical care today, and considering the size of legal settlements resulting from automobile accidents, insurance companies recommend coverage of at least $100,000 per person and $300,000 per occurrence.

Property damage liability coverage pays for the repair of damage that the insured vehicle does to the property of another person. Such damage is covered up to the amount specified in the policy. In the preceding example, the third number (50) indicates that the insurance company will pay up to $50,000 to repair property damage. Insurance companies generally recommend at least $100,000 worth of property damage liability.

Along with other automobile liability insurance, most car owners also purchase protection for the passengers in their own cars. A *medical payments endorsement* can be included in automobile coverage for a small additional premium. This endorsement provides for the payment of medical bills, up to a specified amount, for passengers (including the policyholder) injured in the policyholder's vehicle. Most insurers sell this coverage in increments of $1,000 or $5,000, up to $25,000. There is no deductible.

Automobile Physical Damage Insurance Liability insurance does not pay for the repair of the insured vehicle. Automobile physical damage insurance is insurance that covers damage to the insured vehicle. Collision insurance pays for the repair of damage to the insured vehicle as a result of an accident. Most collision coverages include a deductible amount—anywhere from $100 up—that the policyholder must pay. The insurance company then pays either the remaining cost of the repairs or the actual cash value of the vehicle (when the vehicle is "totaled"), whichever is less. For most automobiles, collision insurance is the costliest coverage. Premiums can be reduced, however, by increasing the deductible amount.

Comprehensive insurance covers damage to the insured vehicle caused by fire, theft, hail, dust storm, vandalism, and almost anything else that could damage a car, except collision and normal wear and tear. With the possible exception of aftermarket stereo systems that are installed by the owner of the car, even the contents of the car are insured. For example, comprehensive coverage will pay for a broken windshield, stolen hubcaps, or small dents caused by a hailstorm. Like collision coverage, comprehensive coverage includes a deductible amount, usually up to $1,000.

Uninsured motorists' insurance covers the insured driver and passengers from bodily injury losses (and in some states, property damage losses) resulting from an accident caused by a driver with no liability insurance. It also covers damage caused by a hit-and-run driver. In some states and with some insurance companies, uninsured motorists' coverage is not automatically included in a typical policy. And yet it is important coverage that is quite reasonable. Often, annual premiums are about $250.

No-Fault Auto Insurance **No-fault auto insurance** is enacted by state law and requires that those suffering injury or loss be reimbursed by their own insurance companies, without regard to who was at fault in the accident. Although there are numerous exceptions, most no-fault laws also limit the rights of involved parties to sue each other.

Massachusetts enacted the first no-fault law in 1971, in an effort to reduce both auto insurance premiums and the crushing caseload in its court system. Since then, at least 15 states have followed suit, while three let residents choose whether to participate in their no-fault systems. Every state with a no-fault law requires coverage for all vehicles registered in the state.

B-4d Business Liability Insurance

Business liability coverage protects the policyholder from financial losses resulting from an injury to another person or damage to another person's property. Both the number of liability claims and the size of settlements have increased dramatically in recent years. The result has been heightened awareness of the need for liability coverage—along with quickly rising premiums for this coverage.

Public liability insurance protects the policyholder from financial losses due to injuries suffered by others as a result of negligence on the part of a business owner or employee. It covers injury or death resulting from hazards at the place of business or from the actions of employees. Examples in which damage claims exceeded a billion dollars include the Deepwater Horizon explosion and oil spill, the emissions cheating scandal at Volkswagen, and the breach of an iron-ore tailings dam at the Samarco Mine in Brazil.[3] More recently, liability claims for business disruptions, cancellations, and failures connected to the COVID-19 pandemic, especially in the entertainment and travel industries, have yet to be fully tallied but are likely to exceed $100 billion in the United States.[4] Malpractice insurance, which is purchased by physicians, lawyers, accountants, engineers, and other professionals, is a form of public liability insurance.

Product liability insurance protects the policyholder from financial losses due to injuries suffered by others as a result of using the policyholder's products. Recent court settlements for individuals injured by defective products have been extremely large. As an example, a Missouri appeals court required Johnson & Johnson to pay $2.1 billion to women who said the company's baby powder and other talc-based products caused their cancers.[5]

Some juries have found manufacturers and retailers guilty of negligence even when the consumer used the product incorrectly. This development and the very large awards given to injured consumers have caused management to take a hard look at potential product hazards. As part of their risk-management efforts, most manufacturers now take the following precautions:

- They include thorough and explicit directions with products;
- They warn customers about the hazards of using products incorrectly;
- They remove from the market those products that are considered hazardous; and
- They test products in-house to determine whether safety problems can arise from either proper *or* improper use.

Such precautions can reduce both the risk of product liability losses and the cost of liability insurance. When the risk of death, injury, or lawsuits cannot be eliminated or at least reduced, some manufacturers simply have discontinued the product.

B-4e Marine (Transportation) Insurance

Marine, or transportation, insurance provides protection against the loss of goods that are being shipped from one place to another. It is the oldest type of insurance, having originated with the ancient Greeks and Romans. The term *marine insurance*

no-fault auto insurance enacted by state law and requires that those suffering injury or loss be reimbursed by their own insurance companies, without regard to who was at fault in the accident

public liability insurance insurance that protects the policyholder from financial losses due to injuries suffered by others as a result of negligence on the part of a business owner or employee

product liability insurance insurance that protects the policyholder from financial losses due to injuries suffered by others as a result of using the policyholder's products was coined at a time when only goods transported by ship were insured. After the huge container ship *Ever Given* ran aground and blocked the Suez Canal for nearly a week, it held up global shipping and disrupted supply chains around the world. Shoei Kise Kaisha, Ltd., the owner of the ship, carried $3 billion in protection from liability, but that amount may not be sufficient to protect it against the widespread claims of damages by the Suez Canal Authority for loss of income during the blockage and by the owners of ships whose cargos were delayed.[6]

Today marine insurance is available for goods shipped over water or land. **Ocean marine insurance** protects the policyholder against loss or damage to a ship or its cargo on the high seas. **Inland marine insurance** protects against loss or damage to goods shipped by rail, truck, airplane, or inland barge. Both types cover losses from fire, theft, and most other hazards.

B-4f Business Interruption Insurance

Business interruption insurance provides protection for a business whose operations are interrupted because of a fire, storm, or other natural disaster. It is even possible to purchase coverage to protect a firm if its employees should go out on strike. For most businesses, interruption coverage is available as an endorsement to a fire insurance policy. Premiums are determined by the amount of coverage and the risks that are covered.

The standard business interruption policy reimburses the policyholder for both loss of profit and fixed costs in the event that it cannot operate. Profit payments are based on profits earned by the firm during some specified period. Fixed-cost payments cover expenses the firm incurs even when it is not operating. Employee salaries normally are not covered by the standard policy. However, they may be included for an increased premium.

B-5 Public and Employer-Sponsored Insurance for Individuals

Both the government and private insurance companies offer a number of different types of coverage for individuals in the United States. In this section, we discuss Social Security, unemployment insurance, workers' compensation, and medical insurance.

B-5a Public Insurance

Federal and state governments offer insurance programs to meet the specific needs of individuals who are eligible for coverage. The Social Security program, established by the Social Security Act of 1935, today provides $1 trillion in benefits to nearly 65 million people, almost one out of every five Americans. The Social Security program—financed by taxes paid by both employees and employers—actually consists of four programs. First, *retirement* benefits are paid to eligible employees and self-employed individuals when they reach age 65. (The full retirement age is rising: For those who were born in 1960 and later, the retirement age is 67.) They can obtain reduced benefits at age 62. Second, *survivor* benefits are paid to a worker's spouse, dependent children, or in some cases dependent parents when a covered worker dies before retirement. Third, *disability* benefits are paid to individuals who have demonstrated that they are severely disabled and unable to work. Benefits continue until it is determined that the individual is no longer disabled. When a person with disabilities reaches age 65, the individual is then eligible for retirement benefits. Fourth, the *Medicare* program provides hospital, medical, and drug coverage. Workers can be covered when they reach age 65. Persons who have received disability benefits for a period of at least 24 months are also eligible for Medicare coverage.

ocean marine insurance insurance that protects the policyholder against loss or damage to a ship or its cargo on the high seas

inland marine insurance insurance that protects against loss or damage to goods shipped by rail, truck, airplane, or inland barge

business interruption insurance insurance protection for a business whose operations are interrupted because of a fire, storm, or other natural disaster

Unlike the federal Social Security program, *unemployment insurance* is a joint program between the federal and state governments. The purpose of the program is to provide benefits (employment services and money) to unemployed workers. The dollar amount and the duration of benefits are determined by state laws. The program is funded by a tax paid by employers.

B-5b Workers' Compensation

Workers' compensation insurance covers medical expenses and provides salary continuation for employees who are injured while on the job. This insurance also pays benefits to the dependents of workers killed on the job. Every state now requires employers to provide some form of workers' compensation insurance; specific benefits are established by the state. Employers may purchase this type of insurance from insurance companies or, in some cases, from the state. Self-insurance can also be used to meet requirements in a few states. State laws do vary; some are more stringent than others. In fact, the low cost of workers' compensation in some states is one of many reasons businesses might choose to locate or move there.

Salary continuation payments to employees unable to work because of injuries sustained on the job normally range from 60 to 75 percent of an employee's usual wage. They may, however, be limited to a specified number of payments. In all cases, they stop when the employee is able to return to work.

Workers' compensation premiums, paid by the employer, generally are computed as a small percentage of each employee's wages. The percentage varies with the type of job and is, in general, higher for jobs that involve greater risk of injury.

B-5c Healthcare Insurance

Today, many employers pay, as an employee benefit, part or all of the cost of healthcare insurance for employees. When the employer does not pay for coverage, most individuals purchase their own healthcare insurance. **Healthcare insurance** covers the cost of medical attention, including hospital care, physicians' and surgeons' fees, prescription medicines, and related services. In addition, some firms also provide employees with dental and life insurance. *Major medical insurance* can also be purchased to extend medical coverage beyond the dollar limits of the standard healthcare insurance policy. In all cases, the types of coverage and the premiums vary according to the provisions of the specific healthcare policy, whether it is paid for by the employer or the individual.

The cost of medical care has been increasing over the last 60 years. National expenditures for healthcare in 2019 amounted to $3.8 trillion, or more than $11,500 per individual, according to the Centers for Medicare & Medical Services (CMS). By 2028, experts estimate that about 20 percent of our gross domestic product will be spent on healthcare.[7] As we saw in Chapter 9, many organizations offer health insurance as a benefit to attract and retain employees. However, they are spending more and more, per employee, every year to do so. Firms are seeing annual premiums for employer-sponsored plans rise about 4 percent a year, reaching a projected $21,342 for a family plan in 2020. In response, most organizations are asking employees to bear an increasing portion of their healthcare coverage. Average employee contributions have risen from 26 percent in 2009 to 29 percent in 2019, and that trend is expected to continue.[8]

In an attempt to keep medical insurance premiums down, insurers have developed a variety of insurance plans that are less expensive than full-coverage plans. Some plans have deductibles of $500 to $1,000. Some require that the policyholder pay 20 to 30 percent of the first $1,000 to $3,000 in medical bills. One additional method that can reduce the cost of healthcare coverage is the use of a health maintenance organization. A **health maintenance organization (HMO)** is an insurance plan that directly employs or contracts with selected physicians and

workers' compensation insurance insurance that covers medical expenses and provides salary continuation for employees who are injured while on the job

healthcare insurance insurance that covers the cost of medical attention, including hospital care, physicians' and surgeons' fees, prescription medicines, and related services

health maintenance organization (HMO) an insurance plan that directly employs or contracts with selected physicians and hospitals to provide healthcare services in exchange for a fixed, prepaid monthly premium hospitals to provide healthcare services in exchange for a fixed, prepaid monthly premium. Although there have been concerns about the quality of care provided by some HMOs, they are expected to grow because they offer a lower-cost alternative to traditional healthcare plans.

Preferred provider organizations (PPOs) offer the services of doctors and hospitals at discount rates or give breaks in copayments (the portion of the bill the insured must pay each time services are used) and deductibles. An insurance company or an employer contracts with a PPO to provide specified services at predetermined fees to PPO members.

The Patient Protection and Affordable Care Act (ACA) and the Health Care and Education Reconciliation Act (HCERA), which then-president Barack Obama signed in 2010, sought to slow the long-term rise in healthcare costs for businesses and government, assure affordable, quality health coverage for all Americans, and end barriers to coverage for people with preexisting medical conditions. "Obamacare" or ACA, as the two laws together are often called, provides access to health insurance for uninsured Americans with preexisting conditions, extends coverage for young adults, expands coverage for early retirees, and holds insurance companies accountable for unreasonable rate hikes. Moreover, a new provision in 2015 ties physician payments to the quality of care they provide to their patients. The ACA, which was upheld by the U.S. Supreme Court in 2012, requires that most Americans purchase health insurance and requires that employers with more than 20 employees provide health insurance to their employees or pay penalties. It also creates state-based health insurance marketplaces (exchanges) through which individuals can purchase coverage, with subsidies available to lower-income individuals. However, Obamacare remains controversial, and Republican politicians have vowed to repeal and replace the ACA with something less restrictive to business. Stay tuned.

B-6 Life Insurance

People may also choose to purchase life insurance or obtain it through their employers. **Life insurance** pays a stated amount of money on the death of the insured individual. The money is paid to one or more beneficiaries to help them pay the insured's final expenses and replace the income they would have earned for a time. A **beneficiary** is a person or organization named in a life insurance policy as a recipient of the proceeds of that policy on the death of the insured.

Life insurance thus provides protection for the beneficiaries of the insured. The amount of insurance needed depends very much on the beneficiaries' situation. A wage earner with three small children generally needs more life insurance than someone who is single. Moreover, the need for life insurance changes as a person's situation changes. When the wage earner's children are grown and on their own, they need less protection (through their parent's life insurance) than they did when they were young.

For a particular dollar amount of life insurance, premiums depend primarily on the age of the insured and on the type of insurance chosen. The older a person is, the higher is the premium. (On average, older people are less likely to survive each year than younger people.) Finally, insurers offer several types of life insurance for customers with varying insurance needs. The price of each type depends on the benefits it provides.

B-6a Term Life Insurance

Term life insurance provides protection to beneficiaries for a stated period of time. Because term life insurance includes no other benefits, it is the least expensive form of life insurance. It is especially attractive to young married couples who want as

preferred provider organization (PPO) an insurance plan that offers the services of doctors and hospitals at discount rates or gives breaks in copayments and deductibles

life insurance insurance that pays a stated amount of money on the death of the insured individual

beneficiary person or organization named in a life insurance policy as a recipient of the proceeds of that policy on the death of the insured

term life insurance life insurance that provides protection to beneficiaries for a stated period of time much protection as possible but cannot afford the higher premiums charged for other types of life insurance.

Most term life policies are in force for a period of one year. At the end of each policy year, a term life policy can be renewed at a slightly higher cost—to take into account the fact that the insured individual has aged one year. In addition, some term policies can be converted into other forms of life insurance at the option of the policyholder. This feature permits policyholders to modify their insurance protection to keep pace with changes in their personal circumstances.

B-6b Whole Life Insurance

Whole life insurance, also called *ordinary life insurance,* provides both protection and savings. In the beginning, premiums generally are higher than those for term life insurance. However, premiums for whole life insurance remain constant for as long as the policy is in force.

A whole life policy builds up savings over the years. These savings are in the form of a **cash surrender value**, which is the amount payable to the holder of a whole life insurance policy if the policy is canceled. In addition, the policyholder may borrow from the insurance company, at a relatively low interest rate, amounts up to the policy's cash surrender value.

Whole life insurance policies are sold in these three forms:

- *Straight life insurance,* for which the policyholder must pay premiums as long as the insured is alive;
- *Limited-payment life insurance,* for which premiums are paid for only a stated number of years; and
- *Single-payment life insurance,* for which one lump-sum premium is paid at the time the insurance is purchased.

Which of these is best for a given individual depends, as usual, on that individual's particular situation and insurance needs.

B-6c Endowment Life Insurance

Endowment life insurance provides protection and guarantees the payment of a stated amount to the policyholder after a specified number of years. Endowment policies generally are in force for 20 years or until the insured person reaches age 65. If the insured dies while the policy is in force, the beneficiaries are paid the face amount of the policy. However, if the insured survives through the policy period, the stated amount is paid to the policyholder.

The premiums for endowment policies generally are higher than those for whole life policies. In return, the policyholder is guaranteed a future payment. Thus, the endowment policy includes a sort of "enforced savings" feature. In addition, the cash surrender values of endowment policies usually are higher than those of whole life policies.

B-6d Universal Life Insurance

Universal life insurance combines insurance protection with an investment plan that offers a potentially greater return than that guaranteed by a whole life insurance policy. Universal life insurance is the newest product available from life insurance companies. It offers policyholders several options unavailable with other types of policies. For example, policyholders may choose to make larger or smaller premium payments, to increase or decrease their insurance coverage, or even to withdraw the policy's cash value without canceling the policy. Essentially, the purchase of universal life insurance combines the purchase of annual term insurance with the buying and selling of investments.

whole life insurance life insurance that provides both protection and savings

cash surrender value the amount payable to the holder of a whole life insurance policy if the policy is canceled

endowment life insurance life insurance that provides protection and guarantees the payment of a stated amount to the policyholder after a specified number of years

universal life insurance life insurance that combines insurance protection with an investment plan that offers a potentially greater return than that guaranteed by a whole life insurance policy

Universal life insurance generally offers lower premiums than whole life insurance. In fact, the premium is often called a *contribution*. However, companies that offer universal life insurance may charge a fee when the policy is first purchased, each time an annual premium is paid, and when funds are withdrawn from the policy's cash value. Such fees tend to decrease the return on the savings account part of the policy.

Summary

Risk—or the possibility of loss or injury—is a part of everyday life for both businesses and individuals. Speculative risks are those that accompany the chance of earning a profit. Pure risks are those that involve only the possibility of loss, without any potential gain.

Individuals and businesses must evaluate the risks they face, and they should minimize the costs involved with those risks. Four general techniques of risk management are risk avoidance, risk reduction, risk assumption, and the shifting of risk. Usually, pure risks that cannot be avoided or reduced and that are too large to be assumed can be shifted to insurance companies.

Insurance companies, for a fee, assume risks that meet certain insurability criteria. They do so through contracts called insurance policies. An important condition in the issuing of an insurance policy is that the insured individual or firm cannot profit from the policy. That is, the payment in the event of a loss cannot exceed the actual amount of the loss. Insurance company fees, or premiums, must be affordable. At the same time, they must be high enough to cover expected payouts and other expenses. Stock insurance companies are profit-making corporations owned by stockholders. Mutual insurance companies are cooperatives owned by their policyholders.

Property and casualty insurance protects the policyholder against loss of property and loss due to accidents. Included in this category is insurance that protects against loss of property due to fire, theft, and various natural hazards; against liability due to injury to employees or customers; and against damage and liability resulting from automobile accidents.

Both the government and private insurance companies offer a number of different types of coverage for individuals in the United States. The federal Social Security program offers retirement, survivor, disability, and Medicare benefits to people who are eligible. Unemployment insurance—a joint program sponsored by the federal and state governments—provides both employment services and money to people who are unemployed. Employers are required to provide workers' compensation insurance to protect the worker in case of injury. An increasing number of employers are making 401(k) salary-reduction savings plans available to their employees. And both employers and individuals purchase insurance to cover healthcare costs.

All life insurance provides a stated amount of money, paid to beneficiaries upon the death of the insured individual. Term insurance provides this single benefit. Whole life insurance provides some savings, as well—in the form of a cash surrender value. Endowment insurance also provides a guaranteed payment at the end of some specified period time. And universal life insurance combines protection with an investment plan.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

risk (B-1)
speculative risk (B-1)
pure risk (B-1)
risk management (B-1)
self-insurance (B-3)
insurer (or insurance company) (B-3)
premium (B-3)
insurance policy (B-3)
insurance (B-3)
insurable risk (B-3)
uninsurable risk (B-3)
principle of indemnity (B-5)
stock insurance company (B-6)
mutual insurance company (B-6)
fire insurance (B-7)
coinsurance clause (B-7)
extended coverage (B-8)
fidelity bond (B-8)
automobile liability insurance (B-8)
no-fault auto insurance (B-10)
public liability insurance (B-10)
product liability insurance (B-10)

ocean marine insurance (B-11)
inland marine insurance (B-11)
business interruption insurance (B-11)
workers' compensation insurance (B-12)
healthcare insurance (B-12)
health maintenance organization (HMO) (B-12)
preferred provider organization (PPO) (B-13)
life insurance (B-13)
beneficiary (B-13)
term life insurance (B-13)
whole life insurance (B-14)
cash surrender value (B-14)
endowment life insurance (B-14)
universal life insurance (B-14)

Endnotes

1. Ryan Smith, "Billions in Insured Losses for 2020 Wildfires – RMS," *Insurance Business Magazine,* December 16, 2020, https://www.insurancebusinessmag.com/us/news/catastrophe/billions-in-insured-losses-for-2020-wildfires--rms-242108.aspx (accessed April 5, 2021); Jessie Roman, Angelo Verzoni, and Scott Sutherland, "Greetings from the 2020 Wildfire Season," *NFPA Journal,* November–December 2020, https://www.nfpa.org/News-and-Research/Publications-and-media/NFPA-Journal/2020/November-December-2020/Features/Wildfire (accessed April 5, 2021); Matthew Lavietes, "Western U.S. Wildfires Cost Insurers Up to $13 Billion in 2020," *Reuters,* December 15, 2020, https://www.reuters.com/article/us-usa-wildfires-insured-losses-trfn/western-u-s-wildfires-cost-insurers-up-to-13-billion-in-2020-idUSKBN28P2NQ (accessed April 5, 2021).
2. Ryan Smith, "Swiss Re Reveals 2020 Insurance Industry Catastrophe Losses," *Insurance Business Magazine,* December 16, 2020, https://www.insurancebusinessmag.com/us/news/catastrophe/swiss-re-reveals-2020-insurance-industry-catastrophe-losses-242065.aspx (accessed April 6, 2021).
3. "Liability Claim Trends 2017," Allianz, https://www.agcs.allianz.com/news-and-insights/expert-risk-articles/global-claims-review-2017-liability-claims-trends.html (accessed April 7, 2021).
4. "Allianz: How COVID-19 Is Changing Claims Trends and Risk Exposures for Companies and Their Insurers," Allianz, press release, October 6, 2020, https://www.allianz.com/en/press/news/studies/201006_Allianz-AGCS-Covid-19-claims-trends-and-risk-exposures.html (accessed April 7, 2021).
5. Roni Caryn Rabin, "Women With Cancer Awarded Billions in Baby Powder Suit," *The New York Times,* June 23, 2020, https://www.nytimes.com/2020/06/23/health/baby-powder-cancer.html?smid=tw-nytimesbusiness&smtyp=cur (accessed April 7, 2021).
6. David Osler, "After Ever Given, What Now for Marine Insurance and Ship Finance?" *Lloyd's List,* March 30, 2021, https://lloydslist.maritimeintelligence.informa.com/LL1136306/After-Ever-Given-what-now-for-marine-insurance-and-ship-finance (accessed April 7, 2021); Leslie Scism and Benoit Faucon, "World News: Insurers Face Host of Claims on Delays," *The Wall Street Journal,* March 29, 2021, p. A6.
7. "NHE Fact Sheet," Centers for Medicare and Medicaid Services, December 16, 2020, https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NHE-Fact-Sheet (accessed April 8, 2021).
8. Kathryn Mayer, "Employer-Sponsored Healthcare Costs Top $21K a Year," *Human Resource Executive,* October 19, 2020, https://hrexecutive.com/employer-sponsored-healthcare-costs-top-21k-a-year/ (accessed April 8, 2021).

APPENDIX C
Business Law, Regulation, and Taxation

Our initial task in this appendix is to examine the sources of laws and the functions of federal and state court systems. Next, we discuss the major categories of laws that apply to business activities: contract law, property law, and laws relating to negotiable instruments, the agent-principal relationship, and bankruptcy. Then we describe federal laws that encourage competition, and we look at the issue of deregulation of business. Finally, we conclude with a discussion of federal, state, and local taxes—the primary means by which all governments finance their activities.

C-1 Laws and the Courts

A **law** is a rule developed by a society to govern the conduct of and relationships among its members. Laws set standards of behavior for both businesses and individuals. They establish the rights of these parties in exchanges and various types of agreements. Laws also provide remedies in the event that one business (or individual) believes that it has been injured by another. In the United States, the supreme law of the land is the U.S. Constitution. The federal, state, and local governments enact and administer laws, but no law is valid if it violates the Constitution.

C-1a Sources of Laws

Each level of government derives its laws from two major sources: (1) judges' decisions, which make up common law, and (2) legislative bodies, which enact statutory laws.

Common Law **Common law**, also known as *case law* or *judicial law,* is the body of law created by court decisions rendered by judges. Common law began as custom and tradition in England. It was then transported to America during the colonial period and, since then, has been further enlarged by the decisions of American judges.

The growth of common law is founded on the doctrine of *stare decisis,* a Latin term meaning "to stand by a previous decision." The doctrine of *stare decisis* is a practical source of law for two reasons. First, a judge's decision in a case may be used by other judges as the basis for later decisions. The earlier decision thus has the strength of law and is, in effect, a source of law. Second, the doctrine of *stare decisis* makes law more stable and predictable. If someone brings a case to court *and* the facts are the same as those in a case that has already been decided, the court will make a decision based on the previous legal decision. The court may depart from the doctrine of *stare decisis* if the facts in the current case differ from those in an earlier case or if business practices, technology, or the attitudes of society have changed.

law a rule developed by a society to govern the conduct of and relationships among its members

common law the body of law created by court decisions rendered by judges; also known as case law or judicial law

Statutory Law A **statute** is a law passed by the United States Congress, a state legislature, or a local government. **Statutory law**, then, consists of all the laws that have been enacted by legislative bodies. For businesses, one very important part of statutory law is the **Uniform Commercial Code (UCC)**, a set of laws designed to eliminate differences among state regulations affecting business and to simplify interstate commerce. The UCC consists of 11 articles, or chapters, that cover sales, commercial paper (short-term debt obligations), bank deposits and collections, letters of credit, transfers of title, securities, and transactions that involve collateral. It has been adopted with variations in all 50 states. The state statutes that the UCC replaced varied from state to state and caused problems for firms that did business in more than one state.

Today, most legal experts have expanded the concept of statutory law to include administrative law. **Administrative law** consists entirely of the regulations created by government agencies established by legislative bodies. The Nuclear Regulatory Commission (NRC), for example, has the power to set specific requirements for nuclear power plants. It can even halt the construction or operation of plants that do not meet such requirements. These requirements thus have the force and effect of law.

Most regulatory agencies hold hearings that are similar to court trials. Evidence is introduced, and the parties are represented by legal counsel. Moreover, the decisions of these agencies may be appealed in state or federal courts.

C-1b Public Law and Private Law: Crimes and Torts

Public law is the body of law that deals with the relationships between individuals or businesses and society. A violation of a public law is called a **crime**. Among the crimes that can affect a business are the following:

- Burglary, robbery, and theft;
- Embezzlement, or the unauthorized taking of money or property by an employee, agent, or trustee;
- Forgery, or the false signing or changing of a legal document with the intent to alter the liability of another person;
- The use of inaccurate weights, measures, or labels;
- The use of the mail to defraud, or cheat, an individual or business;
- The receipt of stolen property; and
- The filing of a false and fraudulent income tax return.

Those accused of violating public laws—or committing crimes—are prosecuted by a federal, state, or local government.

Private law is the body of law that governs the relationships between two or more individuals or businesses. A violation of a private law is called a **tort**. In some cases a single illegal act—such as embezzlement—can be both a crime and a tort.

Torts may result either from intentional acts or from negligence. Such acts as shoplifting and embezzlement are intentional torts. **Negligence**, on the other hand, is a failure to exercise reasonable care, resulting in injury to another. Suppose that the driver of a delivery truck loses control at the wheel and rams into a building. A tort has been committed, and the owner of the building may sue both the driver and the driver's employer to recover the cost of repairing the damage. Among the torts that can affect a business are the following:

- *Slander*—A false oral statement that injures a person's or business's reputation;
- *Libel*—A false written statement that injures a person's or business's reputation;
- *Fraud*—A misrepresentation of facts designed to take advantage of another individual or business;
- *Product liability*—A manufacturer's responsibility for negligence in designing, manufacturing, or providing operating instructions for its products;

statute a law passed by the United States Congress, a state legislature, or a local government

statutory law all the laws that have been enacted by legislative bodies

Uniform Commercial Code (UCC) a set of laws designed to eliminate differences among state regulations affecting business and to simplify interstate commerce

administrative law the regulations created by government agencies established by legislative bodies

public law the body of law that deals with the relationships between individuals or businesses and society

crime a violation of a public law

private law the body of law that governs the relationships between two or more individuals or businesses

tort a violation of a private law

negligence a failure to exercise reasonable care, resulting in injury to another

- *Personal injury*—Damage caused by accidents, intentional acts, or defective products; and
- *Unfair competitive practices*—Behavior of an entity that unfairly lessens another organization's ability to compete.

The purpose of private law is to provide a remedy for the person or business injured by a tort. In most cases, the injured party must bring a legal action and present the facts in a court of law. Either a judge or jury will then render a decision. In most cases, the remedy consists of monetary damages to compensate the injured party and punish the person committing the tort. For example, the courts ruled that Samsung committed a tort by infringing on Apple's patent rights on the iPhone. Samsung was forced to pay Apple $533 million in damages.[1] Because large dollar settlements have become commonplace, many business owners and politicians insist that there is a need for tort reform.

C-1c The Court System

The United States has two separate and distinct court systems. The federal court system consists of the Supreme Court of the United States, which was established by the Constitution, and other federal courts that were created by Congress. In addition, each of the 50 states has established its own court system. Figure C-1 shows both the federal court system and a typical state court system.

The Federal Court System Federal courts generally hear cases that involve

- Questions of constitutional law;
- Federal crimes or violations of federal statutes;
- Property disputes between citizens of different states or between a U.S. citizen and a foreign nation;
- Bankruptcy; the Internal Revenue Service (IRS); the postal laws; or copyright, patent, and trademark laws; and
- Admiralty and maritime cases.

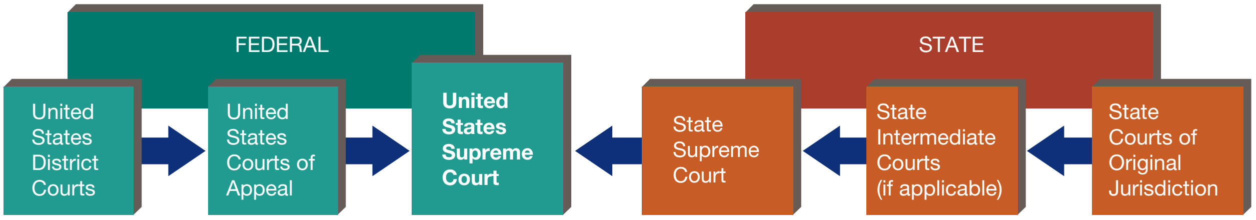
The United States is divided into federal judicial districts. Each state has at least one district court, and more populous states have two or more. A district court is a **court of original jurisdiction**, which is the first court to recognize and hear testimony in a legal action. In many cases the decision reached in the district court may be appealed to a higher court. A court that hears cases appealed from lower courts is called an **appellate court**. If the appellate court finds the lower court's ruling to be in error, it may reverse that ruling, modify the decision, or return the case to the lower court for a new trial. Currently, there are 13 U.S. Courts of Appeals.

The U.S. Supreme Court—the highest court in the land—consists of nine justices (the chief justice and eight associate justices). The Supreme Court has original jurisdiction in cases that involve ambassadors and consuls and in certain cases involving one or more states. However, its main function is to review decisions made by the U.S. Courts of Appeals and, in some cases, by state supreme courts.

court of original jurisdiction the first court to recognize and hear testimony in a legal action

appellate court a court that hears cases appealed from lower courts

Figure C-1 The Court System


FEDERAL
United States District Courts
United States Courts of Appeal
United States Supreme Court
State Supreme Court
State Intermediate Courts (if applicable)
State Courts of Original Jurisdiction
STATE

The State Court Systems The state court systems are quite similar to the federal system in structure. All have courts of original jurisdiction and supreme courts, and most have intermediate appellate courts as well. The decision of a state supreme court may be appealed to the U.S. Supreme Court if it involves a question of constitutional or federal law.

Other Types of Courts Other courts have been created to meet special needs at both the federal and state levels. A **court of limited jurisdiction** hears only specific types of cases. At the federal level, for example, Congress has created courts to hear cases that involve international trade, taxes and disputes with the IRS, and bankruptcy. At the state level, there are small-claims courts, which hear cases involving claims for less than a specified dollar amount (usually $1,500 or $25,000, depending on the state), traffic courts, divorce courts, juvenile courts, drug courts, mental health courts, and probate courts.

C-2 Contract Law

Contract law is perhaps the most important area of business law because contracts are so much a part of doing business. Every businessperson should understand what a valid contract is and how a contract is fulfilled or violated. A **contract** is a legally enforceable agreement between two or more competent parties who promise to do or not to do a particular thing. An *implied contract* is an agreement that results from the actions of the parties. For example, a person who orders dinner at a local Chili's restaurant assumes that the food will be served within a reasonable time and will be fit to eat. The restaurant assumes that the customer will pay for the meal. Most business contracts, however, are more explicit and formal than that between a restaurant and its customers. An *expressed contract* is one in which the parties involved have made oral or written promises about the terms of their agreement.

C-2a Requirements for a Valid Contract

To be valid and legally enforceable, a contract must meet five specific requirements as follows: (1) voluntary agreement, (2) consideration, (3) legal competence of all parties, (4) lawful subject matter, and (5) proper form.

Voluntary Agreement **Voluntary agreement** consists of both an *offer* by one party to enter into a contract with a second party and *acceptance* by the second party of all the terms and conditions of the offer. If any part of the offer is not accepted, there is no contract. And if it can be proved that coercion, undue pressure, or fraud was used to obtain a contract, it may be voided by the injured party.

Consideration A contract is a binding agreement only when each party provides something of value to the other party. The value or benefit that one party furnishes to the other party is called **consideration**. This consideration may be money, property, a service, or the promise not to exercise a legal right. However, the consideration given by one party need not be equal in dollar value to the consideration given by the other party. As a general rule, the courts will not void a contract just because one party got a bargain.

Legal Competence All parties to a contract must be legally competent to manage their own affairs and must have the authority to enter into binding agreements. The intent of the legal competence requirement is to protect individuals who may not have been able to protect themselves. The courts generally will not require minors, persons of unsound mind, or those who entered into contracts while they were intoxicated to comply with the terms of their contracts.

court of limited jurisdiction a court that hears only specific types of cases

contract a legally enforceable agreement between two or more competent parties who promise to do or not to do a particular thing

voluntary agreement a contract requirement consisting of an offer by one party to enter into a contract with a second party and acceptance by the second party of all the terms and conditions of the offer

consideration the value or benefit that one party to a contract furnishes to the other party

Lawful Subject Matter A contract is not legally enforceable if it involves an unlawful act. Certainly, a person who contracts with an arsonist to burn down a building cannot go to court to obtain enforcement of the contract. Equally unenforceable is a contract that involves **usury**, which is the practice of charging interest in excess of the maximum legal rate. Other contracts that may be unlawful include promissory notes resulting from illegal gambling activities, contracts to bribe public officials, agreements to perform services without required licenses, and contracts that restrain trade or eliminate competition.

Proper Form of Contract Businesses generally draw up all contractual agreements in writing so that differences can be resolved readily if a dispute develops. Figure C-2 shows that a contract need not be complicated to be legally enforceable.

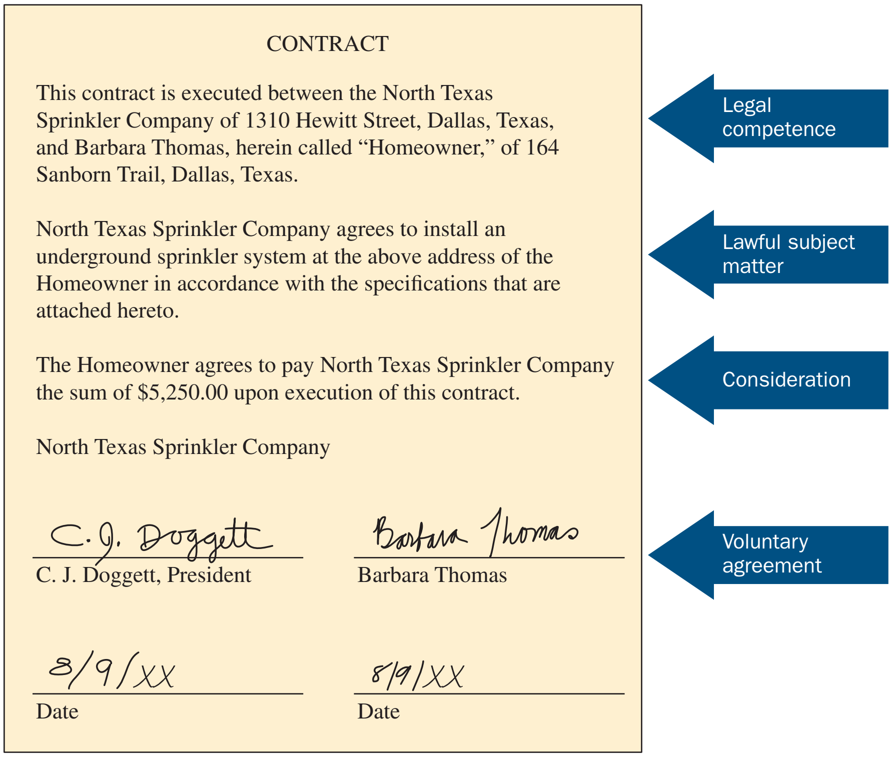
A written contract must contain the names of the parties involved, their signatures, the purpose of the contract, and all terms and conditions to which the parties have agreed. Any changes to a written contract should be made in writing, initialed by all parties, and attached to the original contract.

The *Statute of Frauds*, which has been passed in some form by all states, requires that certain types of contracts be in writing to be enforceable. These include contracts dealing with

- The exchange of land or real estate;
- The sale of goods, merchandise, or personal property valued at $500 or more;
- The sale of securities, regardless of the dollar amount;
- Acts that will not be completed within one year after the agreement is made;
- A promise to assume someone else's financial obligation; and
- A promise made in contemplation of marriage.

usury the practice of charging interest in excess of the maximum legal rate

Figure C-2 Contract Between a Business and a Customer



CONTRACT

This contract is executed between the North Texas Sprinkler Company of 1310 Hewitt Street, Dallas, Texas, and Barbara Thomas, herein called "Homeowner," of 164 Sanborn Trail, Dallas, Texas.

North Texas Sprinkler Company agrees to install an underground sprinkler system at the above address of the Homeowner in accordance with the specifications that are attached hereto.

The Homeowner agrees to pay North Texas Sprinkler Company the sum of $5,250.00 upon execution of this contract.

North Texas Sprinkler Company

C. J. Doggett
C. J. Doggett, President

Barbara Thomas
Barbara Thomas

8/9/XX
Date

8/9/XX
Date

Legal competence

Lawful subject matter

Consideration

Voluntary agreement

C-2b **Performance and Nonperformance**

Ordinarily, a contract is terminated by **performance**, which is the fulfillment of all obligations by all parties to the contract. Occasionally, however, performance may become impossible. Death, disability, or bankruptcy, for example, may legally excuse one party from a contractual obligation. However, what happens when one party simply does not perform according to a legal contract? A **breach of contract** is the failure of one party to fulfill the terms of a contract when there is no legal reason for that failure. In such a case, it may be necessary for the other parties to the contract to bring legal action to discharge the contract, obtain monetary damages, or require specific performance. **Discharge by mutual assent** is the termination of a contract when all parties agree to void the contract. Any consideration received by the parties must be returned when a contract is discharged by mutual assent.

Damages are a monetary settlement awarded to a party injured through a breach of contract. When damages are awarded, an attempt is made to place the injured party in the position it would be in if the contract had been performed. For example, if a landlord wins a lawsuit against a tenant for breach of contract, the court is likely to award the landlord damages in the amount of the unpaid rent.

Specific performance is the legal requirement that the parties to a contract fulfill their obligations according to the contract. Generally, the courts require specific performance if a contract calls for a unique service or product unobtainable from another source.

Most individuals and organizations enter into a contract expecting to live up to its terms. Very few end up in court. When they do, it is usually because one or more of the parties did not understand all the conditions of the agreement. Thus, it is imperative to know what you are signing before you sign it. If you have any doubt, get legal help! A signed contract is very difficult—and often very costly—to void.

C-2c **Sales Agreements**

A **sales agreement** is a special (but very common) type of contract by which ownership is transferred from a seller to a buyer. Article 2 of the UCC (entitled "Sales") provides much of our sales law, which is derived from both common and statutory law. Among the topics included in Article 2 are rights of the buyer and seller, acceptance and rejection of an offer, inspection of goods, delivery, transfer of ownership, and warranties.

Article 2 also provides that a sales agreement may be binding even when one or more of the general contract requirements are omitted. For example, a sales agreement is legally binding when the selling price is left out of the agreement. Article 2 requires that the buyer pay the reasonable value of the goods at the time of delivery. Key considerations in resolving such issues are the actions and business history of the parties and any customary sales procedures within the particular industry.

Finally, Article 2 deals with warranties—both express and implied. An **express warranty** is a written explanation of the responsibilities of the producer (or seller) in the event that a product is found to be defective or otherwise unsatisfactory. An **implied warranty** is a guarantee imposed or required by law. In general, the buyer is entitled to assume that

- The merchandise offered for sale has a clear title and is not stolen;
- The merchandise is as advertised; and
- The merchandise will serve the purpose for which it was manufactured and sold.

Any limitation to an express or implied warranty must be clearly stated so that the buyer can understand any exceptions or disclaimers.

performance the fulfillment of all obligations by all parties to the contract

breach of contract the failure of one party to fulfill the terms of a contract when there is no legal reason for that failure

discharge by mutual assent termination of a contract by mutual agreement of all parties

damages a monetary settlement awarded to a party injured through a breach of contract

specific performance the legal requirement that the parties to a contract fulfill their obligations according to the contract

sales agreement a type of contract by which ownership is transferred from a seller to a buyer

express warranty a written explanation of the responsibilities of the producer (or seller) in the event that a product is found to be defective or otherwise unsatisfactory

implied warranty a guarantee imposed or required by law

C-3 Additional Laws That Affect Business

In addition to contract law, many other kinds of law affect the way a firm does business. In this section, we describe the impact of laws relating to property, negotiable instruments, the agent-principal relationship, and bankruptcy on the day-to-day operations of a business.

C-3a Property Law

Property is anything that can be owned. The concept of private ownership of property is fundamental to the free-enterprise system. The United States Constitution guarantees to individuals and businesses the right to own property and to use it in their own best interests.

Kinds of Property Property is legally classified as either real property or personal property. **Real property** is land and anything permanently attached to it. The term also applies to water on the ground and minerals and natural resources beneath the surface. Thus, a house, a factory, a garage, and a well are all considered real property.

The degree to which a business is concerned with real property law depends on its size and the kind of business it is. The owner of a small convenience store needs only a limited knowledge of real property law. However, a national grocery-store chain such as Albertson's might employ several real estate experts with extensive knowledge of real property law, property values, and real estate zoning ordinances throughout the country.

Personal property is all property other than real property. Personal property that has physical or material value—such as inventories, equipment, store fixtures, an automobile, or a book—is referred to as *tangible personal property* because it is movable and can be felt, tasted, or seen. Property that derives its value from a legal right or claim is called *intangible personal property.* Examples include stocks and bonds, receivables, trademarks, patents, and copyrights.

A *trademark or service mark* is a word, phrase, symbol, and/or design that is registered with the U.S. Patent and Trademark Office. Some examples include brand names, slogans, and logos. Registration guarantees the owner the exclusive use of the trademark forever provided the owner files specific documents and pays fees at regular intervals. The owner may at times have to defend the trademark from unauthorized use—usually through legal action. McDonald's was forced to do exactly that when the trademark "Big Mac" was used by another fast-food outlet in a foreign country.

A **patent** is the exclusive right to make, use, or sell or to license others to make and sell a newly invented product or process. Patents are granted by the U.S. Patent and Trademark Office for a period ranging from 14 to 20 years. After that period has elapsed, the invention becomes available for general use.

A **copyright** is the exclusive right to publish, perform, copy, or sell an original work. Copyright laws cover fiction and nonfiction, plays, poetry, musical works, photographs, films, and computer programs. For example, the copyright on this textbook is held by the publisher, Cengage. The copyright on the movie *The Avengers,* and all its sequels, is held by Walt Disney. A copyright is usually held by the creator or the owner of the work and is generally in effect for the lifetime of the creator or owner plus 70 years. The copyright for certain works, including those created for an employer, lasts 120 years from creation or 95 years from publication, whichever occurs first.

Transfer of Ownership The transfer of ownership for both real property and personal property usually involves either a purchase, a gift, or an inheritance. As we noted earlier, the Statute of Frauds requires that exchanges of real estate

property anything that can be owned

real property land and anything permanently attached to it

personal property all property other than real property

patent the exclusive right to make, use, or sell a newly invented product or process

copyright the exclusive right to publish, perform, copy, or sell an original work be in writing. A **deed** is a written document by which the ownership of real property is transferred from one person or organization to another. The deed must contain the names of the previous owner and the new owner, as well as a legally acceptable description of the property being transferred. A **lease** is an agreement by which the right to use real property is temporarily transferred from its owner, the landlord, to a tenant. In return for use of the property, the tenant generally pays rent on a monthly or yearly basis. A lease is granted for a specific period of time, after which a new lease may be negotiated. If the lease is terminated, the right to use the real property reverts to the landlord.

Transfer of ownership for personal property depends on how payment is made. When the buyer pays the *full cash price* at the time of purchase, the title to personal property passes to the buyer immediately. When the buyer purchases goods on an *installment plan,* the title passes to the buyer upon possession of the property. Although the full cash price has not been paid, the buyer has made a legally enforceable promise to pay it. This is sufficient consideration for the transfer of ownership. Moreover, if the purchased property is stolen from the buyer, the buyer still must pay the full purchase price.

C-3b Laws Relating to Negotiable Instruments

A **negotiable instrument** is a written document that (1) is a promise to pay a stated sum of money and (2) can be transferred from one person or firm to another. In effect, a negotiable instrument is a substitute for money. Checks are the most familiar form of negotiable instruments. However, promissory notes, drafts, certificates of deposit, and commercial paper are also negotiable. Even a warehouse receipt can qualify as a negotiable instrument if certain conditions are met.

Requirements for Negotiability The UCC establishes the following conditions for negotiability:

- The credit instrument must be in writing and signed;
- The instrument must contain an unconditional promise or order to pay a stated sum of money;
- The instrument must be payable on demand or at a definite future date; and
- The instrument must be payable to a specified person or firm or to the bearer.

A financial document that does not meet all these requirements is not negotiable. It may still be valid and legally enforceable, but it cannot be transferred to another business or individual.

Endorsements To transfer a negotiable instrument, the payee (the person named on the face of the document) must sign it on the back. The payee's signature on the back of a negotiable instrument is called an **endorsement**. There are three types of endorsements, as shown at the bottom of Figure C-3.

A *blank endorsement* consists only of the payee's signature. It is quick, easy, and dangerous because it makes the instrument payable to anyone who gets possession of it—legally or otherwise. A *restrictive endorsement* states the purpose for which the instrument is to be used. For example, the words *for deposit only* mean that this check *must* be deposited in the specified account. A *special endorsement* identifies the person or firm to whom the instrument is payable. The words *Pay to the order of Robert Jones* mean that the only person who can cash, deposit, or negotiate this check is Robert Jones.

C-3c Agency Law

An **agency** is a business relationship in which one party, called the *principal,* appoints a second party, called the *agent,* to act on its behalf. Most agents are independent

deed a written document by which the ownership of real property is transferred from one person or organization to another

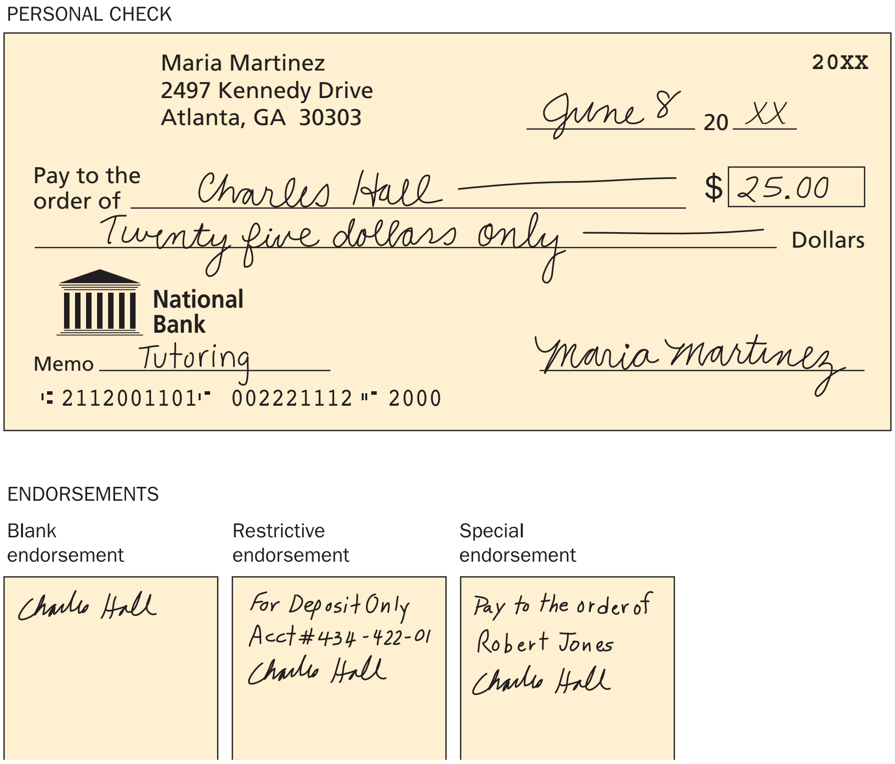
lease an agreement by which the right to use real estate, equipment, or other assets is temporarily transferred from its owner to the user

negotiable instrument a written document that (1) is a promise to pay a stated sum of money and (2) can be transferred from one person or firm to another

endorsement the payee's signature on the back of a negotiable instrument

agency a business relationship in which one party, called the principal, appoints a second party, called the agent, to act on its behalf

Figure C-3 **Endorsements**



PERSONAL CHECK

Maria Martinez
2497 Kennedy Drive
Atlanta, GA 30303

20XX

June 8 20 XX

Pay to the order of Charles Hall $ 25.00

Twenty five dollars only Dollars

National Bank

Memo Tutoring

Maria Martinez

⑆2112001101⑆ 002221112⑈ 2000

ENDORSEMENTS

Blank endorsement

Charles Hall

Restrictive endorsement

For Deposit Only
Acct #434-422-01
Charles Hall

Special endorsement

Pay to the order of
Robert Jones
Charles Hall

businesspeople or companies and are paid for their services with either set fees or commissions. They are hired to use their special knowledge for a specific purpose. For example, real estate agents are hired to sell or buy real property, insurance agents are hired to sell insurance, and theatrical agents are hired to obtain engagements for entertainers. Lawyers, accountants, and stockbrokers also act as agents.

Almost any legal activity that can be accomplished by an individual also can be accomplished through an agent. (The exceptions are voting, giving sworn testimony in court, and making a will.) Moreover, under the law, the principal is bound by the actions of the agent. However, the principal may sue an agent who performs an unauthorized act and may collect damages. For this reason, a written contract describing the conditions and limits of the agency relationship is extremely important to both parties.

A **power of attorney** is a legal document that serves as evidence that an agent has been appointed to act on behalf of a principal. In most states in the United States, a power of attorney is required in agency relationships involving the transfer of real estate, as well as in other specific situations.

An agent is responsible for carrying out the principal's instructions in a professional manner, for acting reasonably and with good judgment, and for keeping the principal informed of progress according to their agreement. The agent also must be careful to avoid a conflict involving the interests of two or more principals. The agency relationship is terminated when its objective is accomplished, at the end of a specified time period, or in some cases when either party renounces the agency relationship.

power of attorney a legal document that serves as evidence that an agent has been appointed to act on behalf of a principal

C-3d Bankruptcy Law

Bankruptcy is a legal procedure designed both to protect an individual or business that cannot meet its financial obligations and to protect the creditors involved. The Bankruptcy Reform Act was enacted in the United States in 1978 and was

bankruptcy a legal procedure designed both to protect an individual or business that cannot meet its financial obligations and to protect the creditors involved amended subsequently in 1984 and 2005. Under the act, bankruptcy proceedings may be initiated by either the person or the business in financial difficulty or by the creditors.

Initiating Bankruptcy Proceedings **Voluntary bankruptcy** is initiated by an individual or business that can no longer meet its financial obligations. Individuals, partnerships, and most corporations may file for voluntary bankruptcy. **Involuntary bankruptcy** is initiated by an organization's or individual's creditors. The creditors must be able to prove that the individual or business has unsecured debts in excess of $16,750 and cannot pay its debts as they come due. It should be noted that involuntary bankruptcy proceedings cannot be initiated against banks and credit unions, insurance companies, nonprofit organizations, or family farms.

Today, most bankruptcies are voluntary. Creditors are wary of initiating bankruptcy proceedings because they usually end up losing most of the money they are owed. They usually prefer to wait and to hope that the debtor eventually will be able to pay.

Resolving a Bankruptcy Case A petition for bankruptcy is filed in a bankruptcy court. If the court declares the individual or business bankrupt, three means of resolution are available: liquidation, reorganization, and repayment.

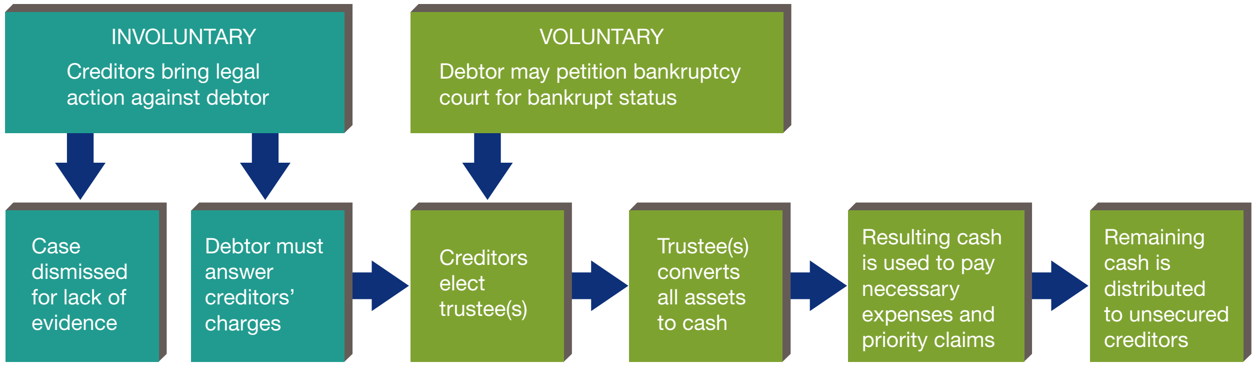
Chapter 7 of the Bankruptcy Reform Act concerns *liquidation*, the sale of assets of a bankrupt individual or business to pay its debts. Figure C-4 depicts the steps involved in Chapter 7 bankruptcy, whether voluntary or involuntary. In principle, the assets of the individual or business are sold to satisfy the claims of creditors. The debtor is then relieved by the court of all remaining debts. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 made it more difficult for individuals to file a Chapter 7 bankruptcy and forces them instead into a Chapter 13 repayment plan, discussed later in this section.

Chapter 11 of the Bankruptcy Reform Act outlines the procedure for *reorganizing* the debts and obligations of an insolvent business. The idea is simple: The distressed business will be preserved by correcting or eliminating the factors that got the firm into financial trouble. To implement this idea, the business petitions the bankruptcy court and files a plan to reorganize its debt. Only a debtor may file a reorganization plan for the first 120 days, unless a trustee has been appointed by the court. After 120 days, any interested party may file a reorganization plan. After the plan has been filed with the court, both the plan and a written disclosure statement are distributed to all individuals and businesses with claims against the bankrupt firm. These people and firms may testify at a hearing held for the purpose of confirming the plan. If the plan is confirmed by the court, the reorganized business emerges from bankruptcy with only the

voluntary bankruptcy a bankruptcy procedure initiated by an individual or business that can no longer meet its financial obligations

involuntary bankruptcy a bankruptcy procedure initiated by creditors

Figure C-4 **Steps Involved in Chapter 7 (Liquidation) of the Bankruptcy Reform Act**


INVOLUNTARY
Creditors bring legal action against debtor
VOLUNTARY
Debtor may petition bankruptcy court for bankrupt status
Case dismissed for lack of evidence
Debtor must answer creditors' charges
Creditors elect trustee(s)
Trustee(s) converts all assets to cash
Resulting cash is used to pay necessary expenses and priority claims
Remaining cash is distributed to unsecured creditors

financial obligations imposed on it by the plan. This is exactly what occurred when USA Rugby, JC Penney, MD America, Gold's Gym, and Cirque du Soleil filed for protection under Chapter 11.

Chapter 13 of the Bankruptcy Reform Act permits a bankrupt individual to file with the courts a plan for *repaying* specific debts. Only individuals with a regular income, less than $394,725 in unsecured debts, and less than $1,184,200 in secured debts are eligible to file for repayment under Chapter 13. The plan must provide for the repayment of specified amounts in up to three years. (In unusual circumstances, the court may extend the repayment period to five years.) If the plan is approved by the court, the individual usually pays the money to a court-appointed trustee in monthly installments. The trustee, in turn, pays the individual's creditors.

C-4 Government Regulation of Business

Government helps to ensure that there is an even playing field for businesses and consumers. In this section, we examine laws designed to promote competition and other areas of regulation in which government oversight is needed to reduce or eliminate abuses.

C-4a Federal Regulations to Encourage Competition

Most states have laws to encourage competition, but for the most part these laws duplicate federal laws. Therefore, here we discuss only federal legislation designed to encourage competition. Federal laws protect consumers by ensuring that they have a choice in the marketplace. The same laws protect businesses by ensuring that they are free to compete.

The need for such laws became apparent in the late 1800s, when trusts, or monopolies, developed in the sugar, whiskey, tobacco, shoe, and oil industries, among others. A **trust** is created when one firm gains control of an entire industry and can set prices and manipulate trade to suit its own interests.

One of the most successful trusts was the Standard Oil Trust, created by John D. Rockefeller in 1882. Until 1911, the Standard Oil Trust controlled between 80 and 90 percent of the petroleum industry. The firm earned extremely high profits primarily because it had obtained secret price concessions from the railroads that shipped its products. Very low shipping costs, in turn, enabled the firm systematically to eliminate most of its competition by deliberately holding prices down. Once this was accomplished, Standard Oil quickly raised its prices.

In response to public outcry against such practices—and high prices—Congress passed the Sherman Antitrust Act in 1890. Since then, Congress has enacted a number of other laws designed to protect American businesses and consumers from monopolies.

The Sherman Antitrust Act (1890) The objectives of the *Sherman Antitrust Act* are to encourage competition and to prevent monopolies. The act specifically prohibits any contract or agreement entered into for the purpose of restraining trade. Specific business practices prohibited by the Sherman Antitrust Act include price fixing, allocation of markets among competitors, and boycotts in restraint of trade. **Price fixing** is an agreement between two businesses about the prices to be charged for goods. A **market allocation** is an agreement to divide a market among potential competitors. A **boycott in restraint of trade** is an agreement between businesses not to sell to or buy from a particular entity. Congress gave the power to enforce the Sherman Antitrust Act to the Department of Justice.

Today, the Sherman Act is still the cornerstone of the federal government's commitment to encourage competition and to break up large businesses that monopolize trade. An amendment to the Sherman Antitrust Act, the *Antitrust*

trust a business combination created when one firm obtains control of an entire industry and can set prices and manipulate trade to suit its own interest

price fixing an agreement between two businesses about the prices to be charged for goods

market allocation an agreement to divide a market among potential competitors

boycott in restraint of trade an agreement between businesses not to sell or buy from a particular entity

Procedures and Penalties Act of 1974, made violation of the Sherman Antitrust Act a felony rather than a misdemeanor. It provides for fines of up to $1 million and prison terms of up to ten years for individuals convicted of antitrust violations. The act also provides that a guilty corporation may be fined up to $100 million and may be sued by competitors or customers for treble monetary damages plus attorneys' fees.

The Clayton Act (1914) Because the wording of the Sherman Antitrust Act is somewhat vague, it could not be used to halt specific monopolistic tactics. Congress therefore enacted the *Clayton Act* in 1914. This legislation identifies and prohibits five distinct practices that had been used to weaken trade competition:

- **Price discrimination**—The practice in which producers and wholesalers charge larger firms a lower price for goods than they charge smaller firms. The Clayton Act does, however, allow quantity discounts.
- **Tying agreement**—A contract that forces an intermediary to purchase unwanted products along with the products it actually wants to buy. This practice was used to "move" a producer's slow-selling merchandise along with its more desirable merchandise.
- **Binding contract**—An agreement that requires an intermediary to purchase products from a particular supplier, not from the supplier's competitors. In return for signing a binding contract, the intermediary was generally given a price discount.
- **Interlocking directorate**—An arrangement in which members of the board of directors of one firm are also directors of a competing firm. Thus, for example, a person may not sit on the board of American Airlines and Delta Air Lines at the same time.
- **Community of interests**—A situation in which one firm acquires a competing firm, usually by buying its most of its stock. If this type of merger substantially lessens competition or tends to create a monopoly, it is unlawful.

The Federal Trade Commission Act (1914) In 1914, Congress also passed the *Federal Trade Commission Act,* which states, "Unfair methods of competition in commerce are hereby declared unlawful." This act also created the **Federal Trade Commission (FTC)**, a five-member committee charged with the responsibility of investigating illegal trade practices and enforcing antitrust laws.

At first, the FTC was limited to enforcing the Sherman Antitrust, Clayton, and FTC Acts. However, with the 1938 *Wheeler-Lea Amendment* to the FTC Act, Congress gave the FTC the power to eliminate deceptive business practices—including those aimed at consumers rather than competitors. This early "consumer legislation" empowered the FTC to deal with a variety of unfair business tactics without having to prove that they endangered competition.

The Robinson-Patman Act (1936) Although the Clayton Act prohibits price discrimination, it does permit quantity discounts. This provision turned out to be a major loophole in the law. It was used by large chain retailers to obtain sizable price concessions that gave them a strong competitive edge over independent stores. To correct this imbalance, Congress passed the *Robinson-Patman Act* in 1936. This law specifically prohibits:

- Price differentials that "substantially" weaken competition, unless they can be justified by the actual lower selling costs associated with larger orders and
- Advertising and promotional allowances, unless they are offered to small retailers, as well as large retailers.

price discrimination the practice in which producers and wholesalers charge larger firms a lower price for goods than they charge smaller firms

tying agreement a contract that forces an intermediary to purchase unwanted products along with the products it actually wants to buy

binding contract an agreement that requires an intermediary to purchase products from a particular supplier, not from the supplier's competitors

interlocking directorate an arrangement in which members of the board of directors of one firm are also directors of a competing firm

community of interests a situation in which one firm acquires a competing firm to reduce competition between the two

Federal Trade Commission (FTC) a five-member committee charged with the responsibility of investigating illegal trade practices and enforcing antitrust laws

The Robinson-Patman Act is more controversial than most antitrust legislation. Many economists believe the act tends to discourage price competition rather than to eliminate monopolies.

The Celler-Kefauver Act (1950) The Clayton Act prohibited building a trust by acquiring competing firms. To get around that prohibition, however, a firm could still purchase the assets of its competitors. The result was the same: the elimination of competition. The *Celler-Kefauver Act* closed this loophole by prohibiting mergers through the purchase of assets if these mergers will tend to reduce competition. The act also requires all proposed mergers to be approved by both the FTC and the Justice Department. As an example, an objection by the FTC to Procter & Gamble's proposed acquisition of Billie, which markets women's shaving and personal care products, over antitrust concerns ultimately derailed the deal. The FTC similarly blocked Edgewell's proposed acquisition of the shaving brand Harry's on the grounds that it would reduce competition because Edgewell already owns the shaving brands Wilkinson, Sword, Edge, Personna, and Skintimate.[2]

The Antitrust Improvements Act (1976) In 1976, Congress passed the *Antitrust Improvements Act* to strengthen previous legislation. This law provided additional time for the FTC and the Justice Department to evaluate proposed mergers, and it expanded the investigative powers of the Justice Department. It also authorized the attorneys general of individual states to prosecute firms accused of price fixing and to recover monetary damages for *consumers*.

The Present Antitrust Environment The challenge with antitrust legislation and its enforcement is defining exactly what an appropriate level of competition is. For example, a particular merger may be in the public interest because it increases the efficiency of an industry. At the same time, however, it may be harmful because it reduces competition. There is really no rule of law (or of economics) that can be applied to determine which of these two considerations is more important in a given case.

Currently, there are three factors that tend to influence the enforcement and effectiveness of antitrust legislation. The first is the growing presence of foreign firms in American markets. Foreign firms have increased competition in America and thus have made it more difficult for any firm to monopolize an industry. Second, most antitrust legislation must be interpreted by the courts because the laws are often vague and open-ended. Thus, the attitude of the courts has a lot to do with the effectiveness of these laws. And finally, political considerations often determine how actively the FTC and the Justice Department pursue antitrust cases. As an example, some consumers and politicians have grown concerned about the size and power of high-tech firms such as Google, Apple, and Facebook. The U.S. Senate has been holding hearings to investigate whether these firms have grown so powerful that they can now stifle competition and innovation in their industries. Facebook in particular has drawn scrutiny over its numerous acquisitions of social media platforms such as Instagram and WhatsApp.[3] Whether there is sufficient political will to act remains to be seen.

C-4b Additional Areas of Regulation

It is impossible to manage even a small business without being affected by local, state, and federal regulations. And it is just as impractical to describe all the government regulations that affect business. In addition to the regulations that affect competition just discussed, we have examined a variety of regulations throughout this text. Chapter 2 discussed laws and regulations dealing with the environment, consumerism, and discrimination; Chapter 3, international trade; Chapter 4, organization of business entities; and Chapter 9, human resources and employee relations. These regulations, when enacted, were designed to level the playing field for all businesses and to protect different classes of people from harm due to business activities. As we saw in Chapter 9, for example, legislation such as the Fair Labor Standards Act, the Equal Pay Act, Title VII of the Civil Rights Act, the Occupational Safety and Health Act, and the Americans with Disabilities Act help ensure that organizations provide safe and equitable workplaces for all Americans regardless of race, ethnicity, gender, age, and ability. Without such regulations, not all businesses would choose to provide such protections.

By now you may think that there must be a government regulation to govern any possible situation. In fact, government regulations increased from the 1930s through the 1970s, but the country then entered a deregulation period that lasted more than 40 years. Today the deregulation drive continues, but there is a question as to how far it should go. Many experts now suggest that any evaluation of government regulations should determine which regulations make sense, which should be modified, and which should be eliminated. Above all, they believe, any reworking of the regulatory environment should create a "livable" environment for consumers, workers, and businesses. We look at the current status of the deregulation movement in the next section.

C-5 The Deregulation Movement

Deregulation is the process of removing existing government regulations, forgoing proposed regulations, or reducing the rate at which new regulations are enacted. The primary aim of the deregulation movement is to minimize the complexity of regulations that affect business and the cost of compliance.

Today, a number of Americans argue that the federal government is out of control and out of touch with the needs of average citizens. They often complain that the federal government has too many employees and spends too much money. In its fiscal year 2020, the U.S. government

- Expected to employ more than 2.8 million civilian workers (including 585,682 U.S. Postal Service employees); and[4]
- Spent nearly $6.6 trillion, which is about $19,962 for every person in the United States. Of course, $1.6 trillion of that went toward COVID-19 relief efforts for businesses, individuals, schools, and local governments.[5]

These critics also complain that there are too many government agencies and too many regulations controlling business activities. More than 100 federal agencies are currently responsible for enforcing an array of regulations. And at least 14 federal agencies now have a direct impact on business firms. These agencies and the activities they regulate are listed in Table C-1.

Advocates of deregulation are quick to point out that every business—large and small—must obey a large number of government regulations and that doing so costs both time and money. Large corporations can more easily cope with the costs of government regulation. They often do so by passing the costs along to stockholders in the form of lower dividends and to consumers in the form of higher prices. Smaller firms generally face fewer regulations, but they may find it harder to cope with that burden. Some, for instance, may not have the staff necessary to comply with the various documentation requirements. And for many small businesses, stiff competition means they cannot pass the burden onto customers in the form of higher prices, so the costs of compliance must be absorbed directly by their owners.

In every presidential election since the 1970s, the candidates elected to office were sincere when they promised the American people that they were prepared to cut unnecessary government spending from the federal budget. Presidents Richard Nixon, Jimmy Carter, Ronald Reagan, George H. W. Bush, Bill Clinton, George W. Bush,

deregulation the process of removing existing government regulations, forgoing proposed regulations, or reducing the rate at which new regulations are enacted

Table C-1 **Government Agencies and What They Regulate**

Government Agency or Commission	Regulates
Consumer Product Safety Commission	Consumer protection
Environmental Protection Agency	Pollution control
Equal Employment Opportunity Commission	Discrimination in employment practices
Federal Aviation Administration	Airline industry
Federal Communications Commission	Radio, television, telephone, and telegraph communications
Federal Energy Regulatory Commission	Electric power and natural gas
Federal Highway Administration	Vehicle safety
Federal Maritime Commission	Ocean shipping
Federal Mine Safety and Health Review Commission	Worker safety and health in the mining industry
Federal Trade Commission	Antitrust, consumer protection
Food and Drug Administration	Consumer protection
Nuclear Regulatory Commission	Nuclear power and nuclear industry
Occupational Safety and Health Review Commission	Worker safety and health
Securities and Exchange Commission	Corporate securities

Barack Obama, Donald Trump, and Joe Biden all had their own ideas on how government should be reorganized. But each president found that government reform is a thorny challenge, often stymied by red tape in federal regulations, duplication of services, rigid civil service rules, and opposition from legislators desiring to protect their favorite agencies or "pork barrel," as well as public sentiment regarding health and safety, particularly after corporate scandals. Each president found that decades of growth and power in government cannot be swept away overnight.

C-6 Government Taxation

Whether you believe that there is too much government or too little, you are required to help pay for it. In one way or another, each of us pays for everything government does—from regulating business to funding research into the causes and cures of cancer. We pay taxes to our local, state, and federal governments on the basis of what we earn, what we own, and even what we purchase.

C-6a Federal Taxes

It takes a lot of money to run something as big as the U.S. government. Each year vast sums are spent for human services, national defense, and interest on the national debt. In addition, the federal government must pay the salaries of its employees, cover its operating expenses, and purchase equipment and supplies that range from paper clips to aircraft carriers. Most of the money comes from taxes. In its fiscal year 2020, the federal government had revenues of nearly $3.5 trillion. About 91 percent of that sum was obtained through taxation.[6]

Individual Income Taxes Individuals' income tax liability is computed from their taxable income, which is gross income less various authorized deductions from income. In 1914, the federal government collected an average of 28 cents per taxpayer. Today that average is about $10,460 per person.

The federal income tax is a progressive tax. A **progressive tax** requires the payment of an increasing proportion of income as the individual's income increases. Taxpayers must file an annual tax return by mid-April each year for the previous calendar year. Their return shows the income, deductions, and computations on which they base their tax liability.

Corporate Income Taxes Corporate income taxes provide approximately 7 percent of total federal revenues. Corporations pay federal income tax only on their taxable income, which is what remains after deducting all legal business expenses from net sales. Currently, the federal corporate tax rate is

Taxable Income	Tax
Not over $50,000	15%
Over $50,000 but not over $75,000	$7,500 + 25% of excess over $50,000
Over $75,000 but not over $100,000	$13,750 + 34% of excess over $75,000
Over $100,000 but not over $335,000	$22,250 + 39% of excess over $100,000
Over $335,000 but not over $10,000,000	$113,900 + 34% of excess over $335,000
Over $10,000,000 but not over $15,000,000	$3,400,000 + 35% of excess over $10,000,000
Over $15,000,000 but not over $18,333,333	$5,150,000 + 38% of excess over $15,000,000
Over $18,333,333	35%

As Table C-2 shows, a corporation with a taxable income of $330,000 must pay a total of $111,950 to the federal government. It is likely that by the time you read this, the corporate tax rate will have increased, in part to pay for COVID-19 stimulus payments and infrastructure investments promised by President Joseph R. Biden.

Other Federal Taxes Additional sources of federal revenue include Social Security, unemployment, and excise taxes, as well as customs duties. An objective of all taxes is to raise money, but excise taxes and customs duties are also designed to regulate the use of specific goods and services.

Table C-2 Federal Corporate Income Tax on an Income of $330,000

According to the tax rate table, the tax is $22,250 plus 39% of the excess over $100,000.

Step 1	Determine the excess over $100,000.
	$330,000
	−100,000
	$230,000
Step 2	Multiply the excess amount (Step 1) by the tax rate (39%).
	$230,000 × 0.39 = $89,700
Step 3	To determine the total tax, add the base amount to the additional tax determined in Step 2.
	$22,250
	+89,700
	$111,950

progressive tax a tax that requires the payment of an increasing proportion of income as the individual's income increases

The second largest source of federal revenue is the *Social Security tax*, which is collected under the Federal Insurance Contributions Act (FICA). This tax provides funding for retirement, disability, and death benefits for contributing employees. FICA taxes are paid by both the employer and the employee. Employees' shares are withheld from their salaries by their employers and sent to the federal government. The Social Security tax is broken into two components: (1) old age, survivors, and disability insurance and (2) Medicare.

Under the provisions of the Federal Unemployment Tax Act (FUTA), employers must also pay an *unemployment tax* equal to 6.0 percent of the first $7,000 of each employee's annual wages. Because employers are allowed credits against the 6.0 percent through participation in state unemployment programs, the actual unemployment rate paid by most employers is 0.6 percent. The tax is paid to the federal government to fund benefits for unemployed workers. Unlike the Social Security tax, the FUTA tax is levied only on employers.

An **excise tax** is a tax on the manufacture or sale of a particular domestic product. Excise taxes are used to help pay for government services directed toward the users of these products and, in some cases, to limit the use of potentially harmful products. As an example, alcohol and tobacco products, which are known to be harmful to consumers, are taxed to raise the prices of these goods and thus discourage consumption. The federal excise tax on gasoline is a source of income that can be used to build and repair highways. Although manufacturers and retailers are responsible for paying excise taxes, these taxes usually are passed on to the consumer in the form of higher retail prices.

A **customs (**or **import) duty** is a tax on a foreign product entering a country. Import duties are designed to protect specific domestic industries by raising the prices of competing imported products. They are first paid by the importer, but the added costs are passed on to consumers through higher—and less competitive—prices.

C-6b State and Local Taxes

Like the federal government, state and local governments are financed primarily through taxes. Sales taxes provide about 35 percent of state and local tax revenues. Most states and some cities also levy taxes on the incomes of individuals and businesses. Finally, many local and county governments also tax consumer sales, real estate, and some forms of personal property.

Sales Taxes Sales taxes are levied by both states and cities and are paid by the purchasers of consumer products. Retailers collect sales taxes as a specified percentage of the price of each taxed product and then forward them to the taxing authority. A sales tax is a regressive tax. A **regressive tax** is one that takes a greater percentage of a lower income than of a higher income. The regressiveness of the sales tax stems from the fact that lower-income households generally spend a greater proportion of their income on taxable products such as food, clothing, and other essentials. Consider the impact of a 5 percent sales tax on food items purchased by a low-income family. A family that earns $30,000 a year and spends $9,000 on food will pay sales taxes of $150, or 1.5 percent of their total earnings. By comparison, a family that earns $80,000 a year and spends $9,000 on food will pay the same amount of sales tax, but the amount represents only 0.56 percent of their total earnings. Not all states collect a sales tax on all items. In fact, many states exempt food and some other products from their sales tax.

Property Taxes Many local governments rely on the property taxes they levy on real estate and personal property owned by businesses and individuals to finance their ongoing activities. *Real estate taxes* usually are computed as a percentage of the assessed value of the real property. (The assessed value is determined by the local tax

excise tax a tax on the manufacture or sale of a particular domestic product

customs (or **import) duty** a tax on a foreign product entering a country

regressive tax a tax that takes a greater percentage of a lower income than of a higher income assessor as the fair market value of the property, a portion of its fair market value, or its replacement cost.) For example, suppose that the city council has established a real estate tax rate of $2.10 per $100 of assessed valuation. Then the property tax bill for an office building with an assessed value of $200,000 will be $4,200 (($200,000 / $100) × $2.10 = $4,200). This type of tax is called a *proportional tax*. A **proportional tax** is one whose percentage rate remains constant as the tax base increases. Therefore, if the tax rate remains constant at $2.10 per $100, a taxpayer who owns real estate valued at $10,000 pays $210 in taxes; a taxpayer who owns real estate valued at $100,000 pays $2,100 in taxes.

Certain personal property owned by businesses and individuals is also subject to local taxation. For businesses, taxable personal property normally includes machinery, equipment, raw materials, and finished inventory. In some cases, local authorities also tax the value of stocks, bonds, mortgages, and promissory notes held by businesses. For individuals, such items as trucks, automobiles, and boats may be classified as personal property and taxed by local authorities.

proportional tax a tax whose percentage rate remains constant as the tax base increases

Summary

In the United States, laws originate in judicial decisions (common law) and in the enactments of legislative bodies and government agencies (statutory law). An important body of statutory law is contained in the Uniform Commercial Code, which has been adopted with variations by all 50 states. Public law is concerned with the relationships between society and its members. Private law is concerned with the relationships among a society's members. To enforce both public and private laws, the United States has two separate and distinct court systems: the federal court system and the court systems of the 50 states.

A contract is a legally enforceable agreement. The conditions for a valid contract include voluntary agreement, consideration, the legal competence of all parties, subject matter that is legal, and proper contract form. A contract is usually terminated through fulfillment of all obligations contained in the contract. Discharge by mutual assent occurs when all parties agree to void a contract. If one party to a contract does not fulfill its obligations, the other party may request the courts to discharge the contract, to award damages for nonperformance, or to require that the terms of the contract be fulfilled. A special type of contract is a sales agreement by which ownership is transferred from a seller to a buyer. Article 2 of the Uniform Commercial Code provides much of our sales law, including the difference between an express warranty and an implied warranty.

Property is everything that can be owned and is classified as either real or personal. Real property is land and anything permanently attached to it. Personal property is all property other than real property. Personal property is also classified as either tangible or intangible. A negotiable instrument, the most common form of which is a check, is a written document that is a promise to pay a stated sum of money and can be transferred from one person or firm to another.

An agency is a business relationship in which an agent acts on behalf of a principal. The principal is generally responsible for, and bound by, all actions of the agent. The agent is responsible for carrying out the instructions of the principal in a reasonable and professional manner.

Bankruptcy laws are designed to protect either a person or a firm that cannot pay its debts and the creditors involved. Bankruptcy proceedings may be initiated by either the creditors (involuntary) or the person or firm that cannot cover its liabilities (voluntary). Bankruptcy proceedings may be resolved through liquidation of the debtor's assets (Chapter 7), reorganization of the bankrupt firm (Chapter 11), or repayment of specific debts incurred by a bankrupt individual (Chapter 13).

Congress passed the Sherman Antitrust Act in 1890, as a means of restoring a reasonable level of competition within industries that had become dominated by trusts. Later antitrust legislation was intended mainly to close loopholes in previous laws. Enforcement of these laws is the responsibility of the Federal Trade Commission and the U.S. Justice Department. In addition to antitrust regulations, a large number of other government regulations at the federal, state, and local level that affect day-to-day business operations are discussed in other chapters in this text.

Government regulation extends to a wide range of business activities, and compliance can be very costly. Regulation increased from the 1930s through the 1970s. A period of deregulation followed, which has lasted more than 30 years and may continue. There is, however, a question as to how much regulation—or deregulation—is most effective in maintaining orderly markets. Many politicians and consumers argue that further deregulation could result in inferior products, dangerous working conditions, polluted air, increased bank failures, and other problems that were prevalent during the 1980s and the first part of the 1990s.

Government supports business by providing information and assistance to business, by funding much of the research that leads to new products and jobs, and by purchasing goods and services that businesses produce. At the same time, government regulates business activity in such a way as to promote competition and protect the interests of consumers.

Federal, state, and local governments finance their activities primarily by collecting taxes. Taxes may be progressive, regressive, or proportional. For the federal government, individual income taxes are the major source of funding. Other sources include corporate income, Social Security, unemployment, excise, and customs taxes. Sales taxes, which are levied on purchases of consumer goods, provide the largest portion of state and local tax revenues. In addition, state and local governments obtain revenues from taxes on property, individual income, corporate income, and other taxable property.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

law (C-1)
common law (C-1)
statute (C-2)
statutory law (C-2)
Uniform Commercial Code (UCC) (C-2)
administrative law (C-2)
public law (C-2)
crime (C-2)
private law (C-2)
tort (C-2)
negligence (C-2)
court of original jurisdiction (C-3)
appellate court (C-3)
court of limited jurisdiction (C-4)
contract (C-4)
voluntary agreement (C-4)
consideration (C-4)
usury (C-5)
performance (C-6)
breach of contract (C-6)
discharge by mutual assent (C-6)
damages (C-6)
specific performance (C-6)
sales agreement (C-6)
express warranty (C-6)
implied warranty (C-6)
property (C-7)
real property (C-7)
personal property (C-7)
patent (C-7)
copyright (C-7)
deed (C-8)
lease (C-8)
negotiable instrument (C-8)
endorsement (C-8)
agency (C-8)
power of attorney (C-9)
bankruptcy (C-9)
voluntary bankruptcy (C-10)
involuntary bankruptcy (C-10)
trust (C-11)
price fixing (C-11)
market allocation (C-11)
boycott in restraint of trade (C-11)
price discrimination (C-12)
tying agreement (C-12)
binding contract (C-12)
interlocking directorate (C-12)
community of interests (C-12)
Federal Trade Commission (FTC) (C-12)
deregulation (C-14)
progressive tax (C-16)
excise tax (C-17)
customs (or import) duty (C-17)
regressive tax (C-17)
proportional tax (C-18)

Endnotes

1 “Apple Awarded $539m in US Patent Case Against Samsung,” *BBC News*, May 25, 2018, https://www.bbc.com/news/business-44248404 (accessed April 9, 2021).

2 Daphne Howland, “P&G, Billie Call Off Their Deal After Federal Antitrust Complaint,” *Retail Dive*, January 6, 2021, https://www.retaildive.com/news/ftc-to-block-pgs-acquisition-of-womens-shaving-startup-billie/591871/ (accessed April 13, 2021).

3 Kelly Anne Smith and Benjamin Curry, “Big Tech in the Crosshairs as Congress Takes Up Antitrust Reform,” *Forbes*, March 15, 2021, https://www.forbes.com/advisor/investing/big-tech-antitrust-reform/ (accessed April 13, 2021).

4 Congressional Research Service, “Federal Workforce Statistics Sources: OPM and OMB,” October 23, 2020, https://fas.org/sgp/crs/misc/R43590.pdf (accessed April 14, 2021), p. 6.

5 “Budget,” *USA Facts*, https://usafacts.org/state-of-the-union/budget/ (accessed April 14, 2021).

6 Ibid.

CENGAGE

ISBN-13: 978-0-357-71794-3
ISBN-10: 0-357-71794-5

90000

9 780357 717943